IN THE DISPUTE RESOLUTION PANEL AT MELBOURNE

(Constituted for a determination as to compensation under Rule 3.16.2 of the National Electricity Rules)

Lake Bonney Wind Power Pty Ltd (ABN 48 104 654 837) and **Woodlawn Wind Pty Ltd** (ABN 38139 165 610) (**Infigen**)

and

Australian Energy Market Operator Limited (ABN 94 072 010 327) (**AEMO**)

AEMO SUBMISSION AS TO COMPENSATION FOR REC LOSSES ON UIGF SCHEDULING ERROR

Introduction

1. This submission relates to an issue that arises out of the matters addressed in a joint submission of the parties and certain others in the matter of a *scheduling error* under the Rules.

2. In this submission, terms have the meaning given to them, if any, in that joint submission. Moreover, matters of background outlined in that joint submission (in particular, in sections A to K and M[1] of that joint submission) apply in this submission.

3. The matters addressed in the joint submission concern the extent of any payment out of the *Participant compensation fund* (the "**fund**") established under the Rules with respect to the entitlement of Infigen (and certain others) to an amount as compensation for (in this case) a declared *scheduling error* involving the incorrect determination of UIGFs.

4. As AEMO understands it, Infigen contends that the amount to be paid to it should include compensation for profit lost with respect to renewable energy certificates (since 1 January 2011, called large-scale generation certificates) (**RECs**) which it was unable to create (and have registered) as a result of the relevant *scheduling error*.

5. AEMO contends that compensation for any such profit lost is either not recoverable from the fund or, in exercise of the DRP's discretion, ought not to be recoverable from the fund.

RECs

[1] But not extending to paragraphs 84 and 85 of the joint submission

6. The entitlement to create RECs arises under the *Renewable Energy (Electricity) Act 2000* ("**Act**"). The original REC scheme under the Act commenced in 2001 and the Act has been amended on 8 occasions since the date on which the first possibly relevant *dispatch interval* occurred (being the date on which Infigen first became a *Semi-Scheduled Generator*, 2 July 2010).

7. Despite those amendments, for present purposes, the gist of the scheme provided for in the Act has remained unchanged.

8. Under that scheme RECs may be created by a person registered under the Act who generates power from a power station accredited under the Act, who generates that power using eligible renewable energy sources (such as wind) and who is nominated in relation to that power station. [2]

9. A REC represents a MWh and can only be created to the extent that MWhs generated from the relevant accredited power station exceed a particular baseline. RECs must be registered when created (and when transferred). Registration is subject to payment of a prescribed fee.

10. The demand for RECs is created by a requirement under the Act imposed on each liable party (usually an electricity retailer). Essentially, such a party must pay a charge to the extent that the amount of registered RECs it surrenders (in MWh) falls short of a percentage (reset periodically) of the electricity it acquires (after taking into account any exemptions, such as might apply if the liable party has acquired partial exemption certificates from participants in emissions intensive trade exposed activities).[3]

11. Value in that demand can be realised by a person registered under the *Renewable Energy (Electricity) Act 2000* who generates power from a power station accredited under the Act using eligible renewable energy sources and who is the nominated person with respect to that power station. Such a person realises that value by creating and registering RECS and then selling them to liable parties (or, insofar as the relevant person is itself a liable party, then surrendering the REC and thereby reducing its own exposure to a charge under the Act).

12. Although a transfer of a REC must be registered, any such sale of a registered REC is negotiated and effected outside the auspices of the Act, by private treaty.

13. RECs could be disposed of in a variety of ways. For example, a person registered under the *Renewable Energy (Electricity) Act 2000* might enter into arrangements for the sale of RECs yet to be created, for the sale of the capacity to create RECs or for the sale of the benefits of the capacity to create RECs.

14. Accordingly, at any particular time:

    a. A REC could only have been created, registered and subsequently sold by Infigen if Infigen was then registered under the Act, its power station was then accredited under the Act, it was then the person nominated with respect to the power station and generation from its power station exceeded any applicable baseline.

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[2] *Renewable Energy (Electricity) Act 2000*, *ss* 8 and 18
[3] *Renewable Energy (Electricity) Act 2000*, *ss 36-38*

b. The net value of a REC will be a function of supply and demand in the private market for RECs at that time and the costs then attributable to its creation and registration. That value is, however, effectively capped at the shortfall charge then applicable under the Act. Historically, there have been significant fluctuations in the market price of RECs.

c. Whether Infigen will have suffered any loss of that net value because of an inability to create and register a REC might depend on the nature of the arrangements, if any, that applied in relation to its creation or disposal of RECs.

Losses potentially compensable-general propositions

15. As indicated above, AEMO contends that compensation for any profit lost with respect to RECs which Infigen was unable to create (and have registered) as a result of the relevant *scheduling error* is either not recoverable from the fund or, in exercise of the DRP's discretion, ought not be recoverable from the fund.

16. An amount in compensation for a loss is only payable from the fund (or, in the exercise of a DRP's discretion, ought only be payable from the fund) if the loss is a direct result of compliance with a *dispatch instruction* which requires *dispatch* at a level lower than that which would have applied absent a *scheduling error*.

17. At the time of preparing this submission AEMO had not had an opportunity to review Infigen's submissions on this issue. It is assumed, however, that Infigen accepts the proposition expressed in the preceding paragraph, given that it is reflective of a decision in 2007 of a DRP comprising eminent members who had considered the matter at length.[4]

18. AEMO also assumes, however, that what is in dispute is a proposition which it contends arises either as a consequence of the need for there to be a direct connection between a *dispatch instruction* and the relevant loss, or as a separate requirement. This is that, in order to be potentially compensable, a loss needs to have been incurred by the relevant *Market Participant* in the ordinary course of its operations in the wholesale electricity market or, at least, in its capacity as a participant in the market.

Limit losses to those incurred in the course of wholesale market operations or as a *Market Participant*

19. The question underlying the issue in dispute is whether (as a matter of construction or discretion) loss suffered as a result of a *scheduling error* by a *Market Participant* with respect to transactions outside the context of the market, or by a *Market Participant* in any capacity, is compensable.

20. *Market Participants* are not entitled to be compensated from the fund for all losses caused by a *scheduling error*. There is an entitlement to be paid "*an amount in compensation*" (cl3.16.2(d)); there is no entitlement to be compensated for losses caused by a *scheduling error*. The

[4] According to the DRP in the decision of 18 October 2007 concerning Snowy Hydro (at [22]) "…*only the direct effect of reduced dispatch brought about by compliance with a dispatch instruction is compensable…".*The DRP in that matter comprised Sir Anthony Mason AC KBE, Mr GE Fitzgerald QC and Mr GH Thorpe. See also that DRP's decision of 29 August 2007, paragraphs 26(i), 26(ii), 27-30, 33, 34 and 36.

entitlement is to receive an amount, as and by way of compensation. Moreover, in determining the amount of any such entitlement, not all losses caused by a *scheduling error* are taken into account.[5]

21. AEMO contends that the provisions of the Rules which create that entitlement, when construed in light of their context and history, make clear an intention to limit that entitlement so that it does not apply to losses incurred with respect to transactions undertaken outside the context of the market, or by a *Market Participant* in any other capacity.

22. Moreover, a construction of the Rules which would have *Market Participants* subsidising, through their contributions to the fund, activities of individual *Market Participants* extraneous to the market in which they all participate would not, it is submitted, be consistent with the purpose or object of the Rules. [6]

23. The fund provisions appear in chapter 3 of the Rules. That chapter sets out the "…*procedures which govern the operation of the market relating to the wholesale trading of electricity and the provision of ancillary services…".*[7] This suggests that the availability of compensation from the fund is tied to operations in that market. In particular, the fund might be considered to have been intended to respond to losses caused by operating in that market, especially given the compulsory nature of participation in the market.

24. Chapter 3 concerns the wholesale electricity trading market constituted by a notional pool for the sale and purchase of electricity. What a participant in that wholesale market does outside that market is a matter for it, on which no relevant reliance is placed on the market operator, AEMO, or on other *Market Participants* (in their capacity as such). Indeed, the position taken by Infigen as to whether and when it might create, register and sell a REC (or as to the arrangements it might enter into in relation to the disposal of RECs) is a matter about which AEMO and other *Market Participants* would have no information.

25. Given that AEMO (as market operator) and the *Market Participants* who ultimately fund *scheduling error* compensation payments have no input into or capacity to control the position Infigen adopts in relation to non-wholesale market arrangements, such as RECs, it is unlikely that it would have been intended that those *Market Participants* bear risk in relation to that position.

26. Money in the fund is sourced from specified *Market Participants*; *Scheduled Generators*, *Semi-Scheduled Generators* and *Scheduled Network Service Providers*.[8] They are the only ones for whose benefit the fund is established[9] and are the only ones with a potential entitlement to be compensated from it.[10]

27. It might well be considered to have been intended that *Market Participants* in these categories share amongst themselves the burden of losses incurred in participating in that market, on the basis that they all share an exposure to losses arising from their market participation where a

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[5] DRP decision concerning Snowy Hydro of 29 August 2007, paragraphs 26(i), 26(ii), 27-30, 33, 34 and 36
[6] See section 7, Schedule 2, National Electricity Law
[7] Clause 3.1.1.
[8] Clause 2.11.3(b)(8). *Scheduled Network Service Providers* provide market network services (clause 2.5.3) and are *Market Participants* (clause 2.4.1(a))
[9] Clause 3.16.1(a).
[10] Clauses 3.16.1(a) and 3.16.2(d)(e)(f) and (g).

scheduling error occurs and, hence, they all benefit from the sharing of that exposure. On the other hand, however, it seems most unlikely to have been intended that *Market Participants* should bear losses that one of their number might incur in:

a. a business it has elected to engage in;

b. a business not all of them engage in (and, hence, not a business the risks of which they all share);

c. a business third parties engage in.

28. The manner in which contributions to the fund are determined reflects an underlying understanding that the fund is to available to respond to losses in the course of wholesale market activities only.[11] Currently, contributions are determined based on a combination of the contributor's metered or scheduled energy and registered capacity, as a proportion of the total energy or capacity of all contributing participants.[12] This contribution structure is consistent with an intention that the fund respond to losses in the wholesale market only, given that contributions to the fund are, essentially, based on a contributor's relative level of involvement in the market. There is no recognition in the structure that the fund ought be available to respond to losses that might be incurred by a particular sub-group of contributors in the course of non-wholesale market activities.

29. In determining the level of compensation to which a *Market Participant* is entitled the DRP is required to use the spot price determined under the Rules. This suggests two things. First, it suggests that it was intended that the type of loss for which an amount in compensation from the fund might be available was loss determinable by reference to the spot price.

30. Secondly, it makes clear that not all loss was intended to be compensated, in that (for example) any adverse impact of the *scheduling error* on the spot price is ignored. Hence, if, for example, a *scheduling error* affected spot price without altering a *Semi-Scheduled Generator*'s instructed operating level, there could be no compensation for the error. This would be so irrespective of the impact of the error on the *Semi-Scheduled Generator*'s position under non-wholesale market arrangements, such as its hedging arrangements.

31. It is submitted that the Rules ought not be construed so that an entitlement to an amount in compensation can exist for losses with respect to non-wholesale market arrangements if, by good fortune, the relevant *Semi-Scheduled Generator*'s output was reduced as a result of the relevant *scheduling error*, but not otherwise. It is unlikely to have been intended that the recoverability of compensation for non-wholesale market losses depend on a fortuitous circumstance.

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[11] AEMO publishes a structure of *Participant fees* (the "**structure**") in accordance with clause 2.11.1 of the Rules, after consultation with *Registered Participants* and other interested parties. The current structure was determined on 21 March 2011, applicable with effect from 1 July 2011 - http://www.aemo.com.au/Electricity/Registration/Budget-and-Fees/Current-Structure-of-Participant-Fees

[12] AEMO last recovered *Participant fees* referable to the fund in 2011/12. Aggregate contributions from *Semi-Scheduled Generators* represented approximately 1.14% of the total. The single *Scheduled Network Service Provider* contributed 1.18% and *Scheduled Generators* contributed 97.68% in aggregate.

32. The fund provisions now found in the Rules were derived from, and remain substantially similar to, fund provisions found in Victoria's wholesale electricity market rules, rules that applied in the 1990s (the VicPool rules).[13]

33. Hence, the current fund provisions were sourced from provisions that would not have been intended to capture losses of the type now claimed by Infigen, especially as the regime for RECs did not then exist.

34. In the DRP's decision of 29 August 2007 involving Snowy Hydro it was noted that a limited entitlement to compensation from the fund is "…*quite consistent with the comparatively small sum in the fund*".[14]

35. A limited entitlement to compensation is not the only implication to arise from the size of the fund. Another implication arises out of the fact that the prescribed size of the fund is the same as that prescribed in relation to the corresponding fund established under the VicPool rules.[15] It is implicit from this that there has been no intention to change the nature of the losses in respect of which the fund might respond, despite the subsequent introduction of the regime for RECs.

36. To an extent, these matters of likely intention of the Rules-making body find direct expression in the Rules.

37. The fund is established for the purpose of paying compensation to, amongst others, *Semi-Scheduled Generators* (cl3.16.1(a)). Only *Market Participants* can apply for compensation from the fund and a DRP may only determine to pay compensation to a *Market Participant* (cls3.16.2(a)(b)). In the circumstances, any entitlement in favour of Infigen to an amount in compensation only arises if it is a *Semi-Scheduled Generator* (cl3.16.2(d)).

38. In this regard, under the Rules:

    a. A generator such as Infigen is taken to be a *Semi-Scheduled Generator* "…*only in so far as its activities relate to a semi-scheduled generating unit*" (cl2.2.7(g)).

    b. Infigen is a *Market Participant* because it is a market generator (cl2.4.1) but a generator is only taken by the Rules to be a market generator in so far as its activities relate to *market generating units* (cl2.2.4(b))

39. Accordingly, when Infigen engages in business activities external to those it engages in as a participant in the wholesale electricity market (also being activities in which non-*Market Participants* engage) it does so other than as a "*Market Participant*" and other than as a "*Semi-Scheduled Generator*". This is because the activities of both a *Market Participant* and a *Semi-Scheduled Generator* in relation to generating units are defined by reference to the wholesale market. For example:

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[13] VicPool, the Victorian wholesale electricity market, commenced in October 1994. See, for example, the rules set out in the Victorian government gazette S48 of 3 May 1997

[14] Paragraph 33 of the decision

[15] VicPool Rules, clause 155.2(b).

a. a *Semi-Scheduled Generator* is required under the Rules to operate its *semi-scheduled generating unit* "*… in accordance with the co-ordinated central dispatch process operated by AEMO under the provisions of Chapter 3"* (cl2.2.7(h)).

b. An entity which is a *Market Participant* by virtue of being a market generator must "…*sell all sent out generation through the spot market and accept payments from AEMO for sent out generation at the spot price applicable at the connection point as determined for each trading interval in accordance with the provisions of Chapter 3"* (cl2.2.4(c)).

40. The upshot is that, in the context of Infigen engaging in business activities external to those it engages in as a participant in the wholesale electricity market, it cannot apply for, it has no entitlement with respect to, and a DRP does not have power to determine to pay in its favour, compensation from the fund.

41. Even if (contrary to AEMO's submissions) amounts might be paid from the fund in compensation for non-wholesale market losses, it is contended that the DRP has discretion in relation to the determination of compensation from the fund[16] and that this discretion ought be exercised in a way which would preclude payment from the fund of such amounts.

42. The DRP may determine compensation and the amount of compensation payable. The term "*may*" indicates a power that may or may not be exercised, at discretion.[17]

43. For the reasons previously identified concerning both the context and history of cl3.16.2 it is submitted that this discretion ought be exercised so as only to allow recovery of a loss incurred by a *Market Participant* in the ordinary course of its operations in the wholesale electricity market or, at least, in its capacity as a participant in that market.

44. In addition, as a DRP compensation determination comprises part of the dispute resolution regime provided for in the Rules, in exercising its discretion in making such a determination the DRP is to be guided by the *national electricity objective*,[18] an objective that focuses on the efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity.[19] Not limiting losses potentially compensable from the fund to those incurred in the ordinary course of wholesale market operations would be inconsistent with that objective. In particular, AEMO contends that:

a. It is not conducive to efficiency to impose on suppliers of electricity into the wholesale electricity market, generally, the burden of losses not incurred in participating in that market. While the sharing of a risk borne by each such supplier might operate to reduce the cost charged for assuming that risk (and, thereby, promote efficiency), imposing on all suppliers the burden of a risk not otherwise borne by each of them creates a cost transfer between generators that may distort investment incentives away from the most efficient outcomes. Put another way, it is not apparent why the DRP should exercise its discretion in

[16] See paragraph 102 of the DRPs Snowy Hydro decision of 1 February 2007 and paragraph 36 of its decision of 29 August 2007.
[17] Section 12, Schedule 2, National Electricity Law as applied to the Rules under clause 1.7.1 of the Rules. This discretion might apply despite evidence of a contrary intent (section 1, Schedule 2, National Electricity Law)
[18] Clause 8.2.1(e)(1).
[19] S7 National Electricity Law

a way that effectively results in suppliers of electricity into the market subsidising renewable energy generators. Market participants, generally, would be cross subsidising a relatively small segment of the wholesale electricity market for no apparent benefit to the market.

b. It is not in the long term interests of electricity consumers to increase the overall costs of operation of the wholesale market by imposing on *Market Participants* the risk, and associated costs, of having to provide compensation for losses incurred in the context of non-wholesale market transactions.

45. As a DRP compensation determination comprises part of the dispute resolution regime provided for in the Rules, in exercising its discretion in making such a determination the DRP is to give recognition to the objective that dispute resolution procedures be simple, quick and inexpensive (cl8.2.1(e)(2)). Not limiting losses potentially compensable from the fund to those incurred in the ordinary course of wholesale market operations would be inconsistent with that objective.

46. If the losses sought by Infigen were to be compensable from the fund, any DRP charged with determining an amount of compensation with respect to those losses would (it is submitted) need to be satisfied as to matters such as Infigen's status (and that of its *generating units*) at all relevant times under the *Renewable Energy (Electricity) Act 2000* and, in relation to each MWh of reduced output resulting from the relevant *scheduling error*, whether a REC would have been created but for that reduction, the timing of creation of the REC, the costs of that creation (and registration) at that time, the timing of sale or surrender of that notional REC, the market price of RECs applicable at that time and the existence and terms of any then applicable arrangements relating to the disposal of RECs . These are matters unlikely to be capable of resolution simply, quickly and inexpensively.

47. As indicated above, previous decisions of a DRP in 2007 involving Snowy Hydro Limited are of particular relevance to the proposition assumed not to be in contention in this proceeding; that a loss is only potentially compensable from the fund if the loss is a direct result of compliance with a *dispatch instruction* which requires dispatch at a level lower than that which would obtain absent a *scheduling error*. It is submitted, however, that some aspects of those decisions are of relevance to the proposition here in issue.

48. In mandating a causal nexus between *dispatch instruction* and loss, the DRP in that matter rejected a contention that compensation under clause 3.16.2 covers all loss suffered by a *Market Participant* in the course of operations as a *Market Participant* as a result of a *scheduling error*.[20]

49. According to the DRP, to determine the loss for which an amount in compensation may be paid under clause 3.16.2 of the Rules:

"*… the Panel must construe cl.3.16.2 as a consistent whole, with each of its provisions aiding the construction of others. Compensation is influenced by a number of factors. The Panel must give effect to cll.3.16.2(b), (d), (e) and (f) and any implications to be derived from cll.3.16.2(c) and (c1) as well as any other relevant provisions of the Rules. Irrespective of whether cll.3.16.2(e) and (f) might sometimes not need to be considered until after the compensation to which a Market*

[20] See Snowy Hydro's contention as reflected in paragraph 26(i) of the DRP's 29 August 2007 decision

Participant would otherwise be entitled has been determined, those provisions are incompatible with Snowy's broad proposition that a relevant Market Participant is entitled to compensation for its total loss in the course of its operations as a relevant Market Participant from a scheduling error."[21]

50. Hence, a loss caused by a *scheduling error* will not necessarily be compensable under clause 3.16.2 even if the loss was suffered in the course of the relevant *Market Participant*'s operations as a *Market Participant*.

51. This must be the more so where, as here, the loss claimed does not arise in the course of operations as a *Market Participant* but, rather, arises from an inability to take advantage of a regime that does not comprise part of the market and, indeed, which is not even mentioned in the Rules under which the market is established and operated.

52. This stands in stark contrast to the situation noted by the DRP in the Snowy Hydro matter. There the DRP clearly considered as relevant the fact that the loss for which compensation was being sought arose under hedging and financial risk management arrangements the entry into of which by *Market Participants* was expressly provided for in the Rules.[22]

53. Snowy Hydro had sought compensation in respect of losses in the *spot market* provided for by Chapter 3 of the Rules, losses of settlement residue auction revenues (called "SRD losses") and hedging contract losses. Consequent upon the DRP's decision mandating a causal nexus between loss and *dispatch instruction*, however, Snowy Hydro dropped the claim with respect to hedging contract losses but pursued, and was successful, in being paid an amount in respect of *spot market* losses and SRD losses.

54. Both the abandonment of any claim to hedging contract losses and the award of payments with respect to *spot market* and SRD losses are reflective of AEMO's contention that amounts in compensation are not payable out of the fund in respect of losses that do not arise out of market operations.

55. In this regard, Snowy Hydro's *spot market* losses clearly arose out of market operations; so too, however, did its SRD losses.[23] Indeed, exemplifying the fact that the transactions under which

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[21] Paragraph 27, decision of 29 August 2007. In the current version (52) of the Rules, references in the Snowy decisions to cll.3.16.2(c1), (d), (e) and (f) should be read as references to cll. 3.16.2(d), (h)(3), (h)(4) and (h)(5) respectively.

[22] Paragraph 100, decision of 1 February 2007

[23] In its publication "*Trading Arrangements in the NEM*" NEMMCO (as AEMO then was) stated (at page 31) that:

"*Although the majority of financial market activity engaged in by generators and retailers occurs through the OTC and futures markets, participants can also use NEMMCO's settlement residue auction process to manage the risk involved in inter-regional trade*.

Because the spot price for electricity in each region of the NEM is determined by supply and demand, the physical limitations of inter-connectors, and the loss factors for the distribution and transmission networks, there may be significant differences in the spot prices across NEM regions.

The difference between the value of electricity in the region where it is generated and its value when sold in a different NEM region is called the inter-regional settlement residue (IRSR). The IRSR that accumulates is made available to the market via the conduct of a quarterly auction. The auction provides participants with a mechanism to manage the risk associated with different price outcomes between trading regions.

the SRD losses were incurred were entered into by Snowy Hydro in the ordinary course of its wholesale market activities is the fact that its purchase of auction units resulted in *settlement residue distribution agreements* with the then market operator, NEMMCO.[24]

In these auctions Market Participants lodge bids for an entitlement to any IRSR that may accumulate across a designated NEM inter-connector. They purchase auction units to obtain access to a share of the residue by means of paying a premium as protection against high spot prices."

[24] The auction of units in the IRSR so as to protect against high price differentials between regions in the wholesale market is still undertaken, as explained in AEMO's publication "An Introduction to Australia's national electricity market" at page 21 and as reflected in clause 3.18 of the Rules