WITHOUT PREJUDICE

STAGE 2 DISPUTE – CLAUSE 8.2.5 NATIONAL ELECTRICITY RULES

Between:

ORIGIN ENERGY ELECTRICITY LIMITED

And

AUSTRALIAN ENERGY MARKET OPERATOR (AEMO)

Preliminary Outline of Position – CS Energy Limited

1. This paper sets out at a high level the position CS Energy Limited would adopt if joined to the Stage 2 dispute set out above.
2. This paper is provided on a without prejudice basis. CS Energy reserves the right to alter our position to respond to detailed submissions.
3. The dispute arises as a result of a challenge by Origin to the allocation of regulating FCAS costs incurred in South Australia in 2015 by AEMO.
4. Other parties allocated those costs in South Australia have sought to join the dispute, and argue alternative interpretations, including to apply these costs to Market Participants across the NEM.
5. The dispute failed to resolve at "stage 1", and Origin have applied for a determination by a dispute resolution panel under Stage 2 of the dispute resolution provisions of the Rules.
6. Clause 8.2 of the National Electricity Rules ("the Rules") sets out the approach to disputes under the Rules.
7. This includes the principles in 8.2.1, which read:

   (e) It is intended that the dispute resolution regime set out in or implemented in compliance with the Rules and described in detail in this rule 8.2 should to the extent possible:

   (1) be guided by the national electricity objective;
   (2) be simple, quick and inexpensive;
   (3) preserve or enhance the relationship between the parties to the dispute;
   (4) take account of the skills and knowledge that are required for the relevant procedure;
   (5) observe the rules of natural justice;
   (6) place emphasis on conflict avoidance; and
   (7) encourage resolution of disputes without formal legal representation or reliance on legal procedures.

8. In our view, AEMO's approach is capable of being supported by the expressed and underlying intention of the Rules.
9. The facts in this dispute are set out substantially in the Outlines of Position of AEMO and Origin. We do not take issue with those facts as described, but reserve the right to challenge any factual contention if joined to the dispute.
10. The approach taken by AEMO with respect to the allocation of costs the subject of this dispute demonstrates a reasonable allocation of costs. In particular, AEMO has (as it has done in the past) applied the Rules, the published Causer Pays Procedure and

Business Specification[1], which have been in place and known by Market Participants for a number of years, and has issued a decision consistent with the principles and intent of the Rules.

11. Most importantly, and despite different arguments and interpretations proposed by parties interested and active in this dispute, there is no clear contravention of the Rules.
12. Indeed Origin, as the main protagonist in the dispute, accepts as its primary argument the principle that these are local costs incurred to address a local South Australian issue, and they should not be allocated on a global basis.
13. That reflects a 2007 Rule change – the National Electricity Amendment (Cost Recovery of Localised Regulation Services) Rule 2007 – 23 August 2007. The AEMC , in its Rule Determination, provided context to the proposed rule as follows:

    The AEMC noted that one of its 2 primary objectives in approving the Rule was:

    "To implement a NEM-wide solution that enables the cost of local regulation FCAS requirements to be recovered from those market participants who had both the capacity and the ability to mitigate their liability at the time the requirements were needed."[2]

    Further, the AEMC stated:

    *"Local market ancillary service requirements, or local FCAS requirements, are required in **abnormal** circumstances where only local market participants have the technical capability to provide FCAS. This is **most often** the case when a region becomes isolated – or "islanded" – due to planned and/or forced outages of transmission elements. A region that has become islanded can also be described as operating asynchronously from other regions within the NEM.*

    Currently, there is a disparity between the way that local regulation FCAS requirements are paid for compared to local contingency FCAS requirements."[3]

    (Emphasis added)

14. In contrast, Origin's second argument, presumably run as an alternative, is that the specific drafting of 3.15.6A(i)(1) requires the use of single TSFCAS, MPF and AMPF values and that therefore the local costs should be allocated across the NEM. That argument lacks basis, and would lead to an outcome that is contrary to Origin's primary contention.
15. That is contrary to the key principle about local issues which Origin clearly accepts, would lead to an outcome that distorts intended outcomes of the Rules, including the 2007 Rule change and the National Electricity Objective, and should be rejected.
16. Clause 3.15.6A(h) requires AEMO to allocate to each region the total amount calculated by AEMO under clause 3.15.6A(a) in accordance with a procedure set out and under clause 3.9.2A(b).
17. Each party objecting to AEMO's decision appears to assume this is a process to aggregate costs to establish a single global sum (TSFCAS) against which MPFs are then applied.
18. In contrast, the process in 3.15.6A(h) is actually separating out costs in respect of each dispatch interval which falls within the trading interval, for allocation to each region (in this case South Australia), on a pro-rata basis using the different marginal prices for local and global services.
19. These are then applied to a calculation in 3.15.6A(i) to work out individual Trading Amounts (i.e. payments) for different Participants. Again, each party objecting to AEMO's decision assumes (because of their assumptions in 17 above), that TSFCAS

[1] AEMO Publication "Efficient Dispatch and Localised Recovery of Regulation Services Business Specification" (Business Specification)
[2] Page 4
[3] Page 3

is a single number, but ignore the references to "the aggregate of" which implies more than one TSFCAS calculation.[4]

20. Further, it seems to be assumed that (h):
    - In (h)(2) derives a single number, which on a correct interpretation, it does not; and
    - Is a complete formula, when in fact (h) describes a procedure and intent for what is ultimately a highly complex and differing calculation depending on the FCAS constraints AEMO is using at the time, the detail for which AEMO administratively sets out separately.
21. In addition, it should be noted that the definitions of *regulating raise service* and *regulating lower service* are at a facility level, making allocation of TSFCAS to a relevant region or regions possible.
22. Clause 3.15.6A(j)(2) recognises that factors for all regions do not need to be calculated by AEMO at all times. The intent is to reduce the administrative burden on AEMO, rather than to allocate costs of a *local ancillary service requirement* on a global basis. The Rule is drafted in a manner that does not preclude AEMO calculating factors when the system is synchronous; instead it is solely a positive obligation to calculate factors when asynchronous.
23. This is reflected at page 14 of the Rule Determination, which reads:

> *"NEMMCO's second round submission noted that the cumulative effect of clauses 3.15.6A(j)(2) and (k)(3) of the draft Rule required it to determine contribution factors for every potential region, or set of regions, prior to an islanding event. Given the large number of possible regions that could result from an islanding event, NEMMCO submitted that it is more practical to determine the actual regional contributions during the settlement process as and when required. NEMMCO also suggested that the clause obliging it to undertake this process this be contained within clause 3.15.6A(i). ...*
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> *The Commission accepts NEMMCO's submission that requiring it to prepare contribution factors for each theoretical region or set of regions before an islanding event has occurred is inappropriate. Accordingly, clause 3.15.6A(j)(2) of the Rule to be made has been amended so that NEMMCO is only required to calculate the factors after an islanding event occurs."*

24. Overall, those parties challenging AEMO's approach do so:
    - Without a clearly correct interpretation under the Rules;
    - Without regard for the clear intent to apply costs locally as represented in the 2007 Rule change, and elsewhere; and
    - Without regard for the localised nature of the costs themselves (see below).
25. In respect of this last matter, the costs themselves are by their nature, localised in that:
    - The quantum of the costs (as set out in AEMO's Outline of Submissions) bear no resemblance to similar services in the NEM outside SA, and reflect the circumstances only of SA;
    - The nature of the Services were specific to SA;
    - They relate to services that could only be provided in SA;
    - They are distinguishable from global costs through the marginal values of the constraint that applied at the time.
26. CS Energy otherwise notes and broadly accepts the Outlines of Position provided by AEMO and Stanwell.
27. In summary:
    - AEMO has undertaken a reasonable allocation of the costs the subject of the dispute;
    - There is no basis, on the arguments put forward, to allocate the costs to parties outside SA, and to do would be inconsistent with the expressed intention of the Rules.

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[4] See Annexure A

- In the circumstances, and having regard to the likely costs involved, prior to the joinder of parties across the NEM perceived to be at risk of being "materially affected" and the formation of the DRP, parties contending for the costs to be re-allocated across the NEM should reconsider whether they have reasonable basis to maintain those arguments in the face of an expressed intention to the contrary.

CS Energy
6 June 2016

Schedule A - High Level Explanation of Working of Rules

The following description is used to provide an indication of how the Rules are to be applied to separate and allocate costs. It is not intended to be comprehensive, but is put forward as a guide to assist the parties' understanding.

FCAS is dispatched through constraint equations in the NEM dispatch engine ('NEMDE'). The constraint equations impose a cost on the NEMDE, with this being calculated as a marginal difference in cost of NEMDE if the constraint be eased by 1MW. This is known as the marginal value. FCAS Prices, where not limited by the price cap or administered price threshold, are the sum of the marginal value of these constraints and in the NEM's uniform price auction all suppliers are paid this price. This is required under 3.9.2A and 3.15.6A(a).

At the time the South Australian price increased substantially, AEMO paid in *trading amounts* for South Australian participants for LREG and RREG under 3.15.6A(a) total 70MW x 13,100/MWh / 12 = $76,416.67. In addition to F_S+RREG_0035 and F_S+LREG_0035 there were trading amounts paid to suppliers in other regions of the NEM dispatched on the basis of constraints F_MAIN++APL_TL_L5, F_I_NIL_MG_R5 and additionally F_T++RREG_0050 (a local requirement in Tasmania). During the period there were numerous different constraints that applied in conjunction with the F_S+RREG_0035 and F_S+LREG_0035 constraints.

These costs arising from paying suppliers of FCAS under 3.15.6A(a) need to be separated in order to allow for local recovery of regulation services as required under the 2007 Rule.

The purpose of 3.15.6A(h),(1) and (2) is to allocate, by separating the total trading amounts (after the contingency and regulation split which has been ignored in this instance) by each *region* and for each dispatch interval on a pro-rata basis given the respective marginal prices of each *service* and to sum these into separate *local* or *global market ancillary service requirements.*

Following on from the simplified example above for RREG 3.15.6A (h) may create:

- Local costs for SA LREG and RREG resulting from F_S+RREG_0035 and F_S+LREG_0035;
- Global costs that apply to all regions including SA LREG and RREG resulting from F_I_NIL_MG_R5;
- Local costs that apply to all Mainland regions including SA LREG and RREG resulting from F_MAIN++APL_TL_L5.

This allocation by region, based on the pro-rata marginal values of the constraints that applied to each and every region, is referred to as TSFCAS (in $) in clause 3.15.6A(i)(1).

The purpose of clause 3.15.6A(i)(1) is to calculate an aggregate trading amount that a Market Generator (for example) must pay AEMO, for each dispatch interval over a trading interval for both global and local market ancillary service requirements. In this case there are three instances of the calculation that are aggregated into a single trading amount for the Market Generator in South Australia.

3.15.6A(i)(1) envisages an individual MPF is used in each instance so in each of these three instances of the calculation a contribution factor must be used, as must an aggregate contribution factor. These factors, 'MPFs', are calculated under 3.15.6A(j). It is because AEMO calculates a Causer Pays factor on the basis of Market Participant as per 3.15.6A(j)(1), they are known as Market Participant Factors.

Importantly there is nothing that prohibits AEMO from calculating for the SA participants numerous MPFs (in this example three different ones) used in each instance (in this example for local, global and mainland arising from three different constraint equations) where there arises numerous TSFCAS of which a share must be aggregated into trading amounts under 3.15.6A(i)(1) for each trading interval.