

Rule Change Notice: AEMO Role in Market Development (RC_2017_05)

This notice is given under clause 2.5.7 of the Wholesale Electricity Market (WEM) Rules (Market Rules).

Submitter: Cameron Parrotte, Australian Energy Market Operator

Date submitted: 7 July 2017

The Rule Change Proposal

In this Rule Change Proposal the Australian Energy Market Operator (AEMO) seeks to clarify and extend its prescribed market development functions under the Market Rules.

AEMO considers it crucial that it should be capable of contributing to the development of the market and efficiency improvements of market processes, and that it should be able to recover costs associated with these activities. AEMO considers that the following contributions to the development of the market are not explicitly addressed in the Market Rules:

- provision of information to the Rule Change Panel, to help the Rule Change Panel understand (and potentially quantify) the market impacts, benefits and costs of Rule Change Proposals;
- provision of support for the periodic reviews of aspects of the WEM design that are undertaken by the Economic Regulation Authority (ERA) in accordance with the Market Rules; and
- development of Rule Change Proposals, where it identifies opportunities for improvements in market operation and administration.

AEMO considers that this contribution to market development will improve the quality and timeliness of regulatory outcomes in the WEM and reduce the burden on Market Participants and other agencies.

While AEMO is not prohibited from performing these functions, the Market Rules do not state explicitly that these are services for which AEMO may seek cost recovery from the market. AEMO seeks to clarify AEMO's prescribed functions and budgetary approval process by explicitly including in the Market Rules a function of AEMO to "promote the development and improve the effectiveness of the operation and administration of the Wholesale Electricity Market, including providing information to the Rule Change Panel and Economic Regulation Authority to support their respective functions".

The Rule Change Panel notes that the potential scope of the new function is very broad. The proposed drafting places no limits on AEMO's market development role, in particular in relation to the development of Rule Change Proposals, and provides no clarity on the boundaries between AEMO's market development role and that of other parties such as the Public Utilities Office (PUO).

The proposed drafting has been paraphrased from a similar function conferred on AEMO in section 49(1)(b) of the National Electricity Law¹. During discussion of the proposal at the 14 July 2017 Market Advisory Committee (MAC) meeting, members noted that the recent Vertigan² and Finkel³ Reviews both reported that there is some confusion regarding AEMO's market development role in the National Electricity Market (NEM). Both reviews have recommended the COAG Energy Council issue AEMO with a "Statement of Role" to provide greater clarity.

The MAC, while acknowledging the importance of AEMO's role in the market and supporting the progression of the Rule Change Proposal, suggested it would be desirable to avoid introducing similar uncertainty into the arrangements in the WEM.

The Rule Change Panel seeks stakeholder views on the role AEMO should play in the development of WEM Rule Change Proposals and whether greater clarity about the boundaries of AEMO's market development role is needed – for example, whether some size or scope limits should apply to the Rule Change Proposals developed by AEMO (for which it recovers its costs from the market), beyond which some form of policy support or direction should be required.

Where stakeholders consider that greater clarity of AEMO's market development role is needed, the Rule Change Panel seeks views on whether this clarity should be provided in the Market Rules, which prescribe the functions for which AEMO may seek cost recovery from the market, or in some other instrument, like the Statement of Role recommended for AEMO in the NEM by the Vertigan and Finkel Reviews.

The Rule Change Panel notes that the proposed amendments affect Protected Provisions and so are subject to Ministerial approval. The Rule Change Panel therefore intends to liaise with the PUO on this Rule Change Proposal, to seek guidance about the new Government's policy position on AEMO's role in the WEM and the respective roles of AEMO, the PUO and other agencies in the ongoing development of the market.

Appendix 1 contains the Rule Change Proposal and gives complete information about:

- the proposed amendments to the Market Rules;
- relevant references to the Market Rules and any proposed specific amendments to those clauses; and
- the submitter's description of how the proposed amendments would allow the Market Rules to better address the Wholesale Market Objectives.

¹ Section 49(1)(b), Schedule –National Electricity Law, *National Electricity (South Australia) Act 1996* provides that AEMO has the function "to promote the development and improve the effectiveness of the operation and administration of the wholesale exchange".

² 'Review of Governance Arrangements for Australian Energy Markets', for which the Final Report is available at <http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Review%20of%20Governance%20Arrangements%20for%20Australian%20Energy%20Markets%20-%20Final%20Report%20-%20Oct%202015.pdf>.

³ 'Independent Review into the Future Security of the National Electricity Market', for which the 'Blueprint for the Future' is available at <http://www.environment.gov.au/system/files/resources/1d6b0464-6162-4223-ac08-3395a6b1c7fa/files/electricity-market-review-final-report.pdf>.

³ Available at <http://www.aemc.gov.au/About-Us/Resources/Memoranda-of-Understanding/AEMC-AEMO-MOU-signed-and-dated.aspx>.

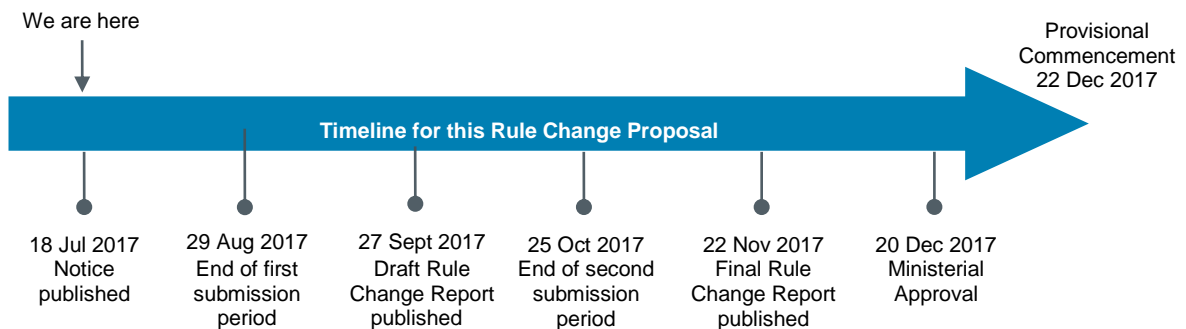
Decision to progress the Rule Change Proposal

The Rule Change Panel has decided to progress this Rule Change Proposal on the basis that its preliminary assessment indicates that the proposal is consistent with the Wholesale Market Objectives.

Timeline

This Rule Change Proposal will be progressed using the Standard Rule Change Process, described in section 2.7 of the Market Rules.

The projected timelines for progressing this proposal are:



Call for submissions

The Rule Change Panel invites interested stakeholders to make submissions on this Rule Change Proposal. The submission period is 30 Business Days from the Rule Change Notice publication date. Submissions must be delivered to the RCP Secretariat by **5:00 PM** on **Tuesday, 29 August 2017**.

The Rule Change Panel prefers to receive submissions by email, using the submission form available at: <https://www.erawa.com.au/rule-change-panel/make-a-rule-change-submission> sent to rcp.secretariat@rcpwa.com.au.

Submissions may also be sent to the Rule Change Panel by post, addressed to:

Rule Change Panel

Attn: Executive Officer
C/o Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

Wholesale Electricity Market Rule Change Proposal

Rule Change Proposal ID: RC_2017_05
Date received: 7 July 2017

Change requested by:

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Date submitted:	7 July 2017
Urgency:	2-medium
Rule Change Proposal title:	AEMO Role In Market Development
Market Rule(s) affected:	2.1A.2, 2.22A.1

Introduction

Clause 2.5.1 of the Wholesale Electricity Market (WEM) Rules (Market Rules) provides that any person may make a Rule Change Proposal by completing a Rule Change Proposal form that must be submitted to the Rule Change Panel.

This Rule Change Proposal can be sent by:

Email to: rcp.secretariat@rcpwa.com.au

Post to: Rule Change Panel
 Attn: Executive Officer
 C/o Economic Regulation Authority
 PO Box 8469
 PERTH BC WA 6849

The Rule Change Panel will assess the proposal and, within 5 Business Days of receiving this Rule Change Proposal form, will notify you whether the Rule Change Proposal will be further progressed.

In order for the proposal to be progressed, all fields below must be completed and the change proposal must explain how it will enable the Market Rules to better contribute to the achievement of the Wholesale Market Objectives.

The objectives of the market are:

- (a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;
- (b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors;
- (c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions;
- (d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system; and
- (e) to encourage the taking of measures to manage the amount of electricity used and when it is used.

Details of the Proposed Rule Change

1. Describe the concern with the existing Market Rules that is to be addressed by the proposed rule change:

As a regulated entity, the Australian Energy Market Operator (**AEMO**) performs functions that are conferred on it by legislation, regulations and other subordinate instruments, including the Wholesale Electricity Market (**WEM**) Rules (**Market Rules**).

AEMO's functions in respect of the WEM, including in its capacity as System Management, are detailed in the following instruments:

- regulations 12 and 13 of the *Electricity Industry (Wholesale Electricity Market) Regulations 2004*;
- the *Australian Energy Market Operator (Functions) Regulations 2015*¹; and
- clauses 2.1A and 2.2 of the Market Rules.

Clause 2.22A.1 of the Market Rules lists the services provided by AEMO for the purpose of determining AEMO's budget. The services (which generally relate to the functions conferred in the instruments listed above) include market operation services, system planning services, market administration services and system management services.

The explicit description of AEMO's functions in the Market Rules is of particular importance due to the regulatory oversight of AEMO's budget to perform its WEM functions. The Allowable Revenue and Forecast Capital Expenditure for each of the above services is determined by the Economic Regulation Authority (**ERA**)² and limits the costs that AEMO may recover from Market Fees in the WEM.³ The ERA may only approve costs, forming part of the Allowable Revenue and Forecast Capital Expenditure, that would be incurred by a prudent provider of

¹ The only function conferred on AEMO by these regulations is "to prepare for the proposed conferral of a function on it under the *Electricity Industry Act 2004* or the *Gas Services Information Act 2012*".

² See clause 2.22.A.2 of the WEM Rules. AEMO must seek approval from the Economic Regulation Authority for its Allowable Revenue and Forecast Capital Expenditure for the services in clause 2.22A.1 of the WEM Rules.

³ See clauses 2.22A.7 and 2.24.

the prescribed services⁴. Given that AEMO operates various electricity and gas markets, both in the east and west of Australia, the ERA also reviews and must approve the methods employed by AEMO to apportion shared costs to WEM Market Participants (for example, costs shared between AEMO's WEM and Gas Services Information functions).

AEMO considers it crucial that it should be capable of contributing to the development of the market and efficiency improvements in market processes, and that it should be able to recover costs associated with these activities. AEMO considers that the following contributions to the development of the market are not explicitly addressed in the Market Rules:

- AEMO's central, independent role in market and system operation means that it is uniquely placed to identify opportunities for improvement in market operation and administration. This is reinforced by experience in both the WEM and the National Electricity Market (**NEM**), where the market and system operator has developed the highest number of Rule Change Proposals.⁵ AEMO considers it would be inefficient for the WEM as a whole if AEMO identified potential improvement opportunities but the WEM relied on other organisations (e.g. Market Participants, the Public Utilities Office or the ERA) to develop the Rule Change Proposals.

While clause 2.5.1 allows anyone, including AEMO, to make a Rule Change Proposal, the Market Rules do not explicitly state that this is a service for which AEMO may seek recovery of costs. In addition, currently the Market Rules do not make it clear that 'market operation services' and 'market administration services' in clause 2.22A.1(a) and (c) extend to market development that is connected with these services.

- Prudent assessment of Rule Change Proposals by the Rule Change Panel requires consideration of market impacts, benefits and implementation costs and approaches. Given that AEMO's IT systems and processes are developed to operationalise numerous aspects of the Market Rules, AEMO expects that the Rule Change Panel will require specific information from AEMO to help it understand (and potentially quantify) market impacts, benefits and costs for the majority of Rule Change Proposals.

AEMO contends that this support for the Rule Change Panel, which can promote timeliness and quality of outcomes, is not clearly expressed to be within the scope of clause 2.22A.1(c) of the Market Rules ("...participation in the Market Advisory Committee and other consultation...") in relation to market administration services.

- The Market Rules require the ERA to undertake periodic reviews of various aspects of the WEM design.⁶ All of these reviews relate to processes performed by AEMO (including in its capacity as System Management). AEMO considers that its support for these reviews is likely to improve their timeliness and effectiveness.

⁴ See clause 2.22A.11(b).

⁵ AEMO and its predecessor (the National Electricity Market Management Company, or NEMMCO) has developed 22 per cent of proposals to amend the National Electricity Rules. In aggregate, the Independent Market Operator (**IMO**) and System Management developed 80 per cent of Rule Change Proposals for the WEM Rules. AEMO notes that its budgets are not subject to regulatory approval for the NEM, and that the IMO was previously conferred responsibility for the rule change process. (Data gathered from <http://www.aemc.gov.au/Rule-Changes> and <https://www.erawa.com.au/rule-change-panel/market-rule-changes> on 18 April 2017.)

⁶ For example the ERA must review the methodology for setting the Benchmark Reserve Capacity Price and Energy Price Limits under clause 2.26.3 of the WEM Rules.

Assistance from AEMO (or System Management) in carrying out the ERA reviews into Ancillary Service Standards and outage planning processes is explicitly required.⁷ However, the periodic reviews of the methodology for setting the Benchmark Reserve Capacity Price and Energy Price Limits (clause 2.26.3), the Planning Criterion and the demand forecasting process (clause 4.5.15), the Relevant Level Methodology (clause 4.11.3C) and the Market Procedure for the Benchmark Reserve Capacity Price (clause 4.16.9) will require greater AEMO involvement than is expressly provided for in the Market Rules.

AEMO considers that the lack of clarity in the Market Rules was reflected in the ERA's "Final Determination Allowable Revenue and Forecast Capital Expenditure for the Australian Energy Market Operator 2016/17 – 2018/19", where the ERA determined that AEMO would only require approximately three full-time equivalent personnel for compliance and rule change development activities for the period 2016/17 to 2018/2019.⁸ AEMO considers that this determination is insufficient to account for the critical input that AEMO can, and should, provide to development (and compliance) of the market.

To address these shortcomings in the Market Rules, AEMO seeks amendments to clarify AEMO's prescribed functions and budgetary approval process by explicitly describing a function of AEMO to "promote the development and improve the effectiveness of the operation and administration of the Wholesale Electricity Market, including providing information to the Rule Change Panel and Economic Regulation Authority to support their respective functions".

The proposed drafting has been paraphrased from a similar function conferred on AEMO in section 49(1)(b) of the National Electricity Law⁹ and adjusted for the WEM context so as to specifically target the activities described above.

AEMO considers that this contribution to market development will improve the quality and timeliness of regulatory outcomes in the WEM and reduce the burden on Market Participants and other agencies. The expected benefits are outlined in more detail in section 5 of this proposal.

AEMO notes that existing processes in the WEM Rules provide oversight and control over the proposed new function for AEMO. Specifically:

- the Allowable Revenue process provides oversight of AEMO's budget for its WEM activities (including apportionment of shared costs), requiring ERA approval and providing stakeholders with opportunities to make submissions to the ERA; and
- monitoring of AEMO's compliance with the Market Rules by the ERA and the annual market audit process (under clauses 2.13 and 2.14 respectively) provide assurance that AEMO continues to perform its core responsibilities. The ERA provides an annual report on AEMO's compliance to the Minister for Energy.

This Rule Change Proposal was presented in draft form to the 14 June 2017 meeting of the Market Advisory Committee (**MAC**). The MAC acknowledged that AEMO has an important role to play in market development and supported the submission of this proposal to the Rule

⁷ Specifically, the assistance of AEMO or System Management is stipulated in clause 3.15.1 (five-yearly Ancillary Service study) and clause 3.18.18 (five-yearly outage planning process review).

⁸ See items 49 to 55, page 14.

⁹ Section 49(1)(b), Schedule –National Electricity Law, *National Electricity (South Australia) Act 1996* provides that AEMO has the function "to promote the development and improve the effectiveness of the operation and administration of the wholesale exchange"

Change Panel. However, it was highlighted that the recent Vertigan¹⁰ and Finkel¹¹ Reviews have both noted that there is confusion around the role that AEMO should play in market development in the NEM, despite the prescribed market development function in section 49(1)(b) of the National Electricity Law. The MAC suggested that it would be desirable to avoid introducing similar uncertainty into the arrangements in the WEM.

Both the Vertigan and Finkel Reviews have acknowledged the strong contribution that AEMO should make to market development activities. To address confusion about the scope of this role, both reviews have recommended that the COAG Energy Council issue AEMO with a 'Statement of Role'. In the Finkel Review, this is contained within Recommendation 7.5 with a target completion of mid-2018. AEMO acknowledges that this will provide greater clarity of AEMO's role in the development of the NEM and that its applicability for AEMO's WEM roles should be considered.

Nevertheless, AEMO recommends that this WEM proposal be progressed at this time as it would provide improved clarity that AEMO does have a role to play in supporting WEM development, when compared to the current Market Rules, to support the next Allowable Revenue process in late 2017. AEMO would support a review of the governance of the WEM as a means to clarify responsibilities between AEMO, the ERA, the Rule Change Panel and the Public Utilities Office, noting that such a review may be best conducted following the finalisation of the AEMO Statement of Role by the COAG Energy Council.

In the meantime, if this proposal is accepted, AEMO will seek to enter into a Memorandum of Understanding between AEMO and each of the ERA and the Rule Change Panel. These documents, which would be publicly available, would document the approach to collaboration between the organisations to assist each organisation in performing its statutory obligations while avoiding inefficient duplication. AEMO notes that it has similar Memoranda of Understanding in place with the Australian Energy Market Commission¹² and the Australian Energy Regulator¹³. AEMO also notes that the Finkel Review has recommended the creation of an Energy Security Board in the NEM, with representation of the AER, AEMC and AEMO, and would welcome discussions with policy makers as to whether a similar approach is warranted in Western Australia.

¹⁰ 'Review of Governance Arrangements for Australian Energy Markets', for which the Final Report is available at

<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Review%20of%20Governance%20Arrangements%20for%20Australian%20Energy%20Markets%20-%20Final%20Report%20-%20Oct%202015.pdf>.

¹¹ 'Independent Review into the Future Security of the National Electricity Market', for which the 'Blueprint for the Future' is available at

<http://www.environment.gov.au/system/files/resources/1d6b0464-6162-4223-ac08-3395a6b1c7fa/files/electricity-market-review-final-report.pdf>.

¹² Available at <http://www.aemc.gov.au/About-Us/Resources/Memoranda-of-Understanding/AEMC-AEMO-MOU-signed-and-dated.aspx>.

¹³ Available at [https://www.aer.gov.au/system/files/MOU%20between%20AER%20and%20AEMO%20\(July%202011\).PDF](https://www.aer.gov.au/system/files/MOU%20between%20AER%20and%20AEMO%20(July%202011).PDF).

2. Explain the reason for the degree of urgency:

As outlined in AEMO's 17 February 2017 adjustment proposal with respect to the 2016-2019 Allowable Revenue and Forecast Capital Expenditure¹⁴, AEMO intends to make a further adjustment proposal to the ERA in late 2017 once clarification has been obtained about the policy direction and underpinning market reform legislation for the WEM.

AEMO considers that the proposed amendments to the Market Rules would provide greater clarity and certainty in respect of the scope of services that can be included in Allowable Revenue and Forecast Capital Expenditure determinations. Timely progression of this Rule Change Proposal via the Standard Rule Change Process is important to enable the proposed Amending Rule, if accepted, to be taken into account in the ERA's determination of AEMO's adjustment proposals with respect to the 2016-2019 Allowable Revenue and Forecast Capital Expenditure.

3. Provide any proposed specific changes to particular Market Rules: *(for clarity, please use the current wording of the rules and place a ~~strikethrough~~ where words are deleted and underline words added)*

2.1A.2. The WEM Regulations also provide for the Market Rules to confer additional functions on AEMO. The functions conferred on AEMO are:

...

(l) to support the Economic Regulation Authority in its role of monitoring market effectiveness, including providing any market related information required by the Economic Regulation Authority; ~~and~~

(IA) to promote the development and improve the effectiveness of the operation and administration of the Wholesale Electricity Market, including providing information to the Rule Change Panel and Economic Regulation Authority to support their respective functions; and

...

...

2.22A.1. For the purposes of this clause 2.22A, the services provided by AEMO are:

...

(c) market administration services, including AEMO's performance of the Procedure Change Process, support for the Rule Change Panel in carrying out its functions under these Market Rules, participation in the Market Advisory Committee and other consultation, ~~to~~ support for monitoring and

¹⁴ '2016-19 Allowable Revenue and Forecast Capital Expenditure Submission to Economic Regulation Authority: Supplemental document to support adjustment to Allowable Revenue and Forecast Capital Expenditure' is available at <https://www.erawa.com.au/electricity/wholesale-electricity-market/determinations/independent-market-operator-imo-system-management-and-australian-energy-market-operator-aemo-allowable-revenue>.

market reviews by the Economic Regulation Authority, audit, registration related functions and other functions under these Market Rules; and

...

4. Describe how the proposed rule change would allow the Market Rules to better address the Wholesale Market Objectives:

AEMO considers that clearer specification of its roles in development of the market and efficiency improvements in market processes will better achieve Wholesale Market Objectives (a) and (d). The proposed amendments would promote earlier rectification of emergent issues in the market that may be affecting market efficiency, security or reliability, and would remove ambiguity in administrative market processes.

AEMO considers that the proposed amendments are consistent with the other Wholesale Market Objectives.

5. Provide any identifiable costs and benefits of the change:

AEMO considers that the proposed amendments would result in the following benefits:

- earlier rectification of emergent issues in the market that may be affecting market efficiency, security or reliability;
- improved timeliness of the rule change processes;
- improved support and greater insights provided to the Rule Change Panel and the ERA for their respective functions; and
- the removal of ambiguity in administrative market processes (specifically the processes associated with AEMO's budget).

AEMO notes that the WA Government's Electricity Market Review (**EMR**) has been the primary source of WA regulatory activity since 2014 and caused prescribed market reviews and other initiatives to be put on hold. Consequently, AEMO oriented its WA regulatory engagement toward participation in the design and implementation of EMR reforms through its WA Market Reform Program. This was reflected in AEMO's proposal "2016-19 Allowable Revenue Submission to the Economic Regulation Authority: September 2016"¹⁵, for which AEMO allocated costs associated with market development activities to its proposed budget for the WA Market Reform Program.

However, AEMO anticipates that the recent commencement of the Rule Change Panel will see WEM rule change activity gather pace in the coming months, particularly until there is clarity on the broader reform program. In addition, the ERA is expected to undertake some of the periodic reviews required by the Market Rules. This will see AEMO's role in market development activities approach a 'business as usual' level, in addition to the broader market reform program (though some synergies between these activities would be expected).

AEMO advises that the incremental cost to its budget for the activities described in this Rule Change Proposal is unclear at this point due to uncertainty over the broader reform program, and that it may fluctuate from time to time with the pace of regulatory change progressed, both via the broader reform program and via the Rule Change Panel. However, AEMO does not

¹⁵ Available at <https://www.erawa.com.au/electricity/wholesale-electricity-market/determinations/independent-market-operator-imo-system-management-and-australian-energy-market-operator-aemo-allowable-revenue>.

presently foresee that the final post-reform resource allocation would exceed three full-time equivalent personnel plus some external consultant support.

AEMO does not consider that this resource allocation represents an additional cost to the market, as other entities would need to perform these activities in the event that this proposal was rejected and AEMO was not resourced appropriately. Notwithstanding this, AEMO would seek to minimise the incremental resource allocation through alignment with corresponding processes and personnel. For example, AEMO anticipates that some synergies would be expected with its EMR-related market development activities, for which the ERA has recently approved an adjustment to AEMO's Allowable Revenue up until the end of 2017¹⁶, and with activities in the other markets that AEMO serves (while ensuring that work and time are adequately monitored to avoid cross-subsidies between the various market fees).

¹⁶ 'Final Determination - Adjustment to AEMO Allowable Revenue 2016-2019', available at <https://www.erawa.com.au/electricity/wholesale-electricity-market/determinations/independent-market-operator-imo-system-management-and-australian-energy-market-operator-aemo-allowable-revenue>.