

Marginal Loss Factor Discussion Forum

Workshop 1 Reflections



Appetite for change

Issue: What scale of change to the MLF calculation approach is desirable for market participants?



What we asked



What scale of change to the MLF framework is desirable?



What are the main drivers for change to MLF frameworks?



How should we consider possible reform across east and west coast markets? [AEMO did not receive substantive comment on this question]



What we heard

- There were many different views about whether change should be incremental or substantial, and many different reasons as to why a certain level of change is desirable (examples below)
- Incremental change was preferred because of aversion to large MLF swings and possible PPA re-opening
- Substantial change was preferred because current process was considered volatile and outdated
- Many stakeholders, even those with different preferences about the nature of framework change, considered that reducing MLF uncertainty and volatility was the main driver for change



Interpretation and implications

- Substantial framework changes may face a material degree of opposition
- Reform measures that target volatility and uncertainty would likely experience most stakeholder support

Timing parameters

Issue: Do the timing parameters that currently underpin MLF calculations support the best outcomes for consumers?



What we asked



Compared to current process, is a more dynamic or a more stable calculation preferred?



What we heard

- Many stakeholders preferred that MLF calculations were more stable, though the preference was not unanimous
- Ideas discussed included diurnal and quarterly MLFs and how to deal with year-on-year weather changes (e.g. rain-drought cycle)
- Stakeholders were interested in the impacts of changing various timing dimensions both in terms of how they'd affect the calculation (e.g. how would weather cycles be reflected?) and in terms of implementing a change (e.g. how would bidding systems need to be updated?)



Interpretation and implications

- The preference for stability is aligned with the view that volatility and uncertainty are key issues with the current process
- Development of concrete proposals for timing parameters may enhance discussions

Calculation philosophy

Issue: Would a change to the MLF calculation philosophy, currently underpinned by minimal extrapolation, improve outcomes for consumers?



What we asked



What sort of issues with the current calculation could be addressed by an alternative philosophy, and why would an alternative philosophy help?



What we heard

- The handling of battery storage (a growing section of the market) was identified as a weakness in the current calculation
- The main alternative calculation approach raised was to develop market models that did not use a minimal extrapolation philosophy to capture battery behaviour
- Separate to workshop 1, MLF methodology consultation submissions expressed the view that completely replacing minimal extrapolation with an alternative market modelling philosophy (e.g. in the style of the ESOO) would reduce MLF uncertainty



Interpretation and implications

- AEMO agrees that there are likely to be better ways to capture battery storage behaviour than current process (which assumes persistence)
- There are specific drivers of battery behaviour (e.g. state of charge and cycling limitations) that make batteries more difficult to incorporate into existing process than other supply sources
- To manage the resource impact, AEMO will first explore whether uncertainty can be reduced or battery treatment can evolve without fundamental change to the calculation approach (minimal extrapolation) for all supply sources
- AEMO notes that there are degrees to which the calculation approach could deviate from minimal extrapolation, and the calculation approach could have elements of different calculation philosophies

Possible reform area 3

Market mechanism

Issue: Are forward-looking MLFs a suitable locational signal for the NEM & WEM?



What we asked



What factors should be considered in deciding how to account for losses?



Are there alternative market mechanisms that AEMO ought to consider?



What we heard

- Presentation of this topic was briefer than planned during the workshop, and stakeholders were encouraged to contact AEMO with further ideas
- A perspective was raised that MLFs are more volatile than average loss factors (ALFs) and ‘overcharge’ regional generators
- A question was asked as to whether it was sensible to use MLFs in dispatch and ALFs in settlement
- Other than brief discussion of ALFs, AEMO received no other feedback or suggestions for alternative market mechanisms to MLFs either during or after the workshop



Interpretation and implications

- AEMO considers that using ALFs would be a substantial departure from the marginal pricing principles that underpin NEM and WEM design
- AEMO notes that proposals to introduce ALFs and, with similar effect, change intra-regional settlement residue distribution were examined by the AEMC in the Adani Renewables rule changes completed in 2020 – though AEMO acknowledges the NEM has evolved since then
- No majority industry interest in a specific alternative to the current market mechanism has yet emerged