

29 January 2016

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Dear Ms Chui

**RE: DRAFT REPORT—STRUCTURE OF PARTICIPANT FEES IN AEMO’S ELECTRICITY MARKETS**

The Energy User Association of Australia (EUAA) has prepared this submission to AEMO in response to the Draft Report on the structure of participant Fees in AEMO’s Electricity Markets 2015.

The EUAA is the peak industry body for Australia’s energy users including manufacturers, retailers and resource-based industries. Our members seek competitive, reliable and sustainable energy supply as a means of running their operations. The EUAA remains the only organisation singularly focused on representing the needs of large energy users in our rapidly evolving volatile energy markets whether it be on electricity, gas, as well as climate change and energy efficiency policy issues.

Given the breadth of the issue the EUAA will focus on two aspects of the Draft Report: The sharing of fees between Market Customers (54%) and Generators (46%). Secondly, that Customer fees are based upon consumption of electricity rather than a fixed fee per service reflecting the fixed costs incurred by AEMO.

**A. Share of Costs between Generators and Customers**

As outlined in the initial consultation paper (September 2015), in allocating costs AEMO identified those costs deemed to be direct, attributable costs to key NEM outputs, and those costs that are deemed to be indirect costs that are allocated to the NEM function. AEMO then identified the key broad outputs (e.g. power system security, metering and settlements) and then allocated NEM direct costs to each of the outputs.

AEMO then allocated the outputs to categories of Registered Participants based on the reflective of involvement criterion and also the simplicity and no unreasonable discrimination criterion. This analysis, though not stipulated in the rules, resulted in 46% of direct allocated costs being apportioned to Generators and Market Network Service Providers (MNSPs) and 54% to Market Customers.

The analysis presented by AEMO shows that the higher share of the costs for Market Customers is largely due to the higher value for reliability and the cost of planning. Whilst we acknowledge these are the direct costs that can be attributed to each segment (Generators, Market customers) of the activities AEMO undertake, there are other very significant costs that Market Customers pay. Notably market customers pay 100% of all the unallocated costs. These unallocated costs (the 30% of AEMO's costs that can not be determined based upon the 'the reflective of involvement criterion' should be shared equally across all registered participants. This proposition is put forward by EUAA members on the grounds that AEMO incurs these costs in administering the NEM in which all registered participants' benefit. The nature of these costs is that they cannot be directly attributable to one group and therefore by definition should be shared equally by all market participants.

Market participants find it difficult to thoroughly comment or challenge the sharing of costs between Generators and Customers as the split is based up an assessment of the allocation of AEMO resources to each of AEMO's tasks. *Market participants are not privy to this information.*

Since this initial analysis was undertaken in 2006 there has been significant changes in the demand profile and a move to distributed generation. Both of these factors could impact on the workload for AEMO.

Due to this information asymmetry market participants are not able to comment or observe if there has been a change in the inputs necessary for AEMO to perform these functions. The value of reliability and planning requirements are likely to remain relatively constant and therefore the changes in the output from AEMO and the associated administrative burden are likely to remain relatively constant. Despite this, as the market participants are liable for these costs it is also appropriate that market participants be able to observe that the costs are efficiently allocated.

The lowest cost approach to providing oversight of AEMO's core functions is likely to be an audit performed by a third-party. Further disclosure of AEMO's costs may also provide this information.

The EUAA therefore recommends that it is prudent that AEMO engage a third party to audit the allocated outputs to categories of Registered Participants.

In addition, 100% of 'unallocated costs' incurred by AEMO are imposed on Market Customers. These unallocated costs are the 30% of AEMO's costs that cannot be determined based by 'the reflective of involvement' criterion. It was determined that a reasonable and efficient method of recovering unallocated costs is from end users via Registered Participants that are closest in the electricity supply chain to those end users. These unallocated costs are imposed on Market Customers on a \$/MWh.

As AEMO incurs these costs in administering the NEM and from the market activities, all registered participants benefit, therefore it is more equitable to share these costs amongst all market participants.

## **B. Structure of Market Customer Charges**

Under the current determination AEMO's costs are recovered through Market Customers through a variable charge (\$/MWh). If this fee structure reflects the costs associated with AEMO providing its services then the costs AEMO incurs for a connection point for a large customer would vary depending upon the value of electricity purchased by the Market Customer.

The Draft Report notes (page 12): "there are fixed costs that AEMO incurs regardless of the amount of energy dispatched." On this basis, the variable charge (\$/MWh) on Market Customers to recover costs from an activity, which has fixed costs, is not reflective of the costs incurred by AEMO in providing a service.

The alternative to a variable charge (\$/MWh) is a fixed charge (\$/Customer connection). A fixed charge is also not an ideal method for allocating costs as it does not reflect the benefit derived by the

Market Customer from the provision of the AEMO service. The Draft Report considers this method and argues that levying a fixed charge on customers is not reflective of involvement (Page 13): “Outside of retail contestability systems, AEMO’s costs were not found to materially increase according to the number of customers.” This statement is however, only a partial consideration of the issue. It is equally true that AEMO’s costs do not increase in proportion with the value of electricity demanded by an individual customer.

The Draft Report also notes that a fixed fee per Registered Participant could discourage competition. Competition is essential to the efficient operation of the market and the Fee Structure should not impair retail competition. A fixed charge may not necessarily impact on competition and this may warrant further consideration.

A fixed charge also ignores the economies of scale, which larger end users have in determining their ‘involvement with AEMO’.

On this basis, neither a variable or fixed charge is appropriate in allocating AEMO costs to Market Participants. The Australian Government’s Cost Recovery Principles establish a framework for the allocation of the costs associated with a regulatory activity. They are also useful in guiding consideration of AEMO’s Market Participant Fees.

These Guidelines establish that fees should be based upon both the specific value of the commodity being traded and the costs of providing the regulatory service.

The current allocation of fees for Market Customers does not reflect this principle.

### **C. Alternative Approach**

An alternative approach to allocating fees is a structure that incorporates both a variable component (\$/MWh) reflecting the value of the commodity and a fixed component (\$/connection point) reflecting the costs to AEMO of performing their functions. This approach would be consistent with the Australian Governments Cost Recovery Principles.

The Draft Report also notes that a fixed charge could discourage competition. Competition is essential to the efficient operation of the market and the Fee Structure should not impair retail competition. A fixed charge also ignores the economies of scale, which larger end users have in determining their ‘involvement with AEMO’.

As noted in the Draft Report, AEMO’s costs relate to managing the energy consumed by end-use customers, on behalf of whom retailers engage with AEMO. Therefore it is appropriate for fees to be levied on retailers in such a way (i.e. customer billing system) that they can readily be passed through to the end-user. A fee structure based upon both a variable and a fixed charge does not appear to prohibit retailers recovering these costs efficiently from their customers.

The most efficient methodology for determining the proportion of fixed and variable costs charged to Market Customers is that they should be in the same proportion as AEMO’s costs in providing the service.

As always the EUAA and its members remain available to discuss any matters that may arise from this submission.

Yours sincerely,

Phil Barresi  
Chief Executive