



1 July 2022

Ms Anna Collyer  
Chair, Australian Energy Market Commission  
GPO Box 2603  
SYDNEY, NSW, 2001

Via electronic lodgment: <https://www.aemc.gov.au/contact-us/propose-rule-change>

Dear Ms Collyer

**RULE CHANGE PROPOSAL - AMENDMENT TO THE ADMINISTERED PRICE CAP TO MITIGATE THE ONGOING THREAT TO THE RELIABLE OPERATION OF THE MARKET AND SYSTEM**

Alinta Energy submits the attached rule change proposal under section 91 of the National Electricity Law, with a request that the AEMC consider it as an urgent rule under section 96(1)(c).

The current energy challenge in eastern Australia has materially impeded the effective operation and administration of the wholesale electricity market which in turn threatens the security and reliability of the interconnected electricity system.

While the NEM has returned to regular operations for now, the threat to the ongoing effective operation and administration of the wholesale electricity market remains. If the relevant underlying market settings are not changed, there is a real risk that we will again see the same conditions that led to the unprecedented dysfunction and suspension of the market. Left unaddressed, these impacts will not deliver outcomes in the long-term interests of consumers.

An expedited Rule process to increase the Administered Price Cap (APC) to a cost reflective level for today's fuel input costs will materially reduce the risk of a repeat of the circumstances behind the market suspension and underpin conditions so that:

- normal market operation and settlement can be maintained; and
- the trade-offs between:
  - having a sufficiently low administered price to mitigate the risk of a systemic financial collapse of the electricity industry during an extreme market event,
  - having a sufficiently high administered price to incentivise market participants to supply electricity during administered price events, and
  - having a sufficiently high administered price to minimise compensation

claims by market participants following the administered price period, are appropriately balanced to meet the long-term interests of consumers.

The attached Rule change request proposes to:

- increase the APC from \$300/MWh to \$600/MWh in every NEM region, with a sunset period of 12 months (or a suitable period as determined by the AEMC with consideration of other processes underway, such as the 2022 Reliability Standard and Settings Review).

For additional information on the Rule change request, please contact Jacinda Papps, Manager, National Wholesale Regulation on [jacinda.papps@alintaenergy.com.au](mailto:jacinda.papps@alintaenergy.com.au) or 0417 065 955.

Yours sincerely



**Daniel McClelland**  
Executive Director, Corporate Services  
Alinta Energy

*Attachment: Rule change proposal*



**Rule Change Proposal:  
Amendment to the Administered Price Cap to  
mitigate the ongoing threat to the reliable  
operation of the market and system**

# 1. Request to make a rule

## 1.1 Name and address of the person making the request

Alinta Energy  
Grosvenor Place  
Level 13, 225 George St  
Sydney NSW 2000

## 1.2 Request to make an expedited rule

This is a request under section 91 of the National Electricity Law for the making of a Rule. Alinta Energy requests that this Rule be treated as an urgent rule under section 96(1)(c) of the National Electricity Law.

Alinta Energy considers the rule change to be urgent as the current energy challenge in eastern Australia has threatened the:

- effective operation and administration of the wholesale electricity market; and
- the security and reliability of the interconnected system.

Alinta Energy considers that the expedited rule change process is justified since, if not made as a matter of urgency, the result may be the continuation of the threat to the ongoing effective operation and administration of the wholesale electricity market and system.

This request to make a Rule is structured to address the information requirements set out in regulation 8(1) of the National Electricity (South Australia) Regulations.

## 2. Description of the proposed rule

The attached Rule change request proposes to:

- increase the APC from \$300/MWh to \$600/MWh in every NEM region, with a sunset period of 12 months (or a suitable period as determined by the AEMC with consideration of other processes underway, such as the 2022 Reliability Standard and Settings Review)<sup>1</sup>.

This will ensure:

- normal market operation and settlement, where prices are reflective of the SRMC of coal and gas generators buying fuels under today's market conditions, can be maintained and dispatch is based on least cost; and

---

<sup>1</sup> For the avoidance of doubt, this will result in the administered floor price also being amended given it is set at the negative of the value of the APC and represents the lower threshold that can be reached in any dispatch interval and any trading interval, during an APP.

- the trade-offs between:
  - having a sufficiently low administered price to mitigate the risk of a systemic financial collapse of the electricity industry during an extreme market event,
  - having a sufficiently high administered price to incentivise market participants to supply electricity during administered price events, and
  - having a sufficiently high administered price to minimise compensation claims by market participants following the administered price period,are sufficiently balanced to meet the long-term interests of consumers.

### **3. Statement of issue**

#### **3.1 Current rule**

The electricity Administered Price Cap (APC) is the maximum market price paid to participants, measured as a \$/MWh value, that can be reached in any dispatch interval and any trading interval, during an Administered Price Period (APP)<sup>2</sup>.

The APC, combined with the Cumulative Price Threshold (CPT), is a mechanism to minimise financial stability risks to the market arising from an extended period of supply scarcity and corresponding high prices with the intention that it is set at a level sufficiently high to incentivise generation to make itself available during an APP.

The APC should be high enough to allow generators to reflect their marginal cost and minimise the likelihood of triggering compensation claims while under the APP, but not so high as to contribute to financial distress of energy purchasers and risk contributing to financial instability in the market in response to extreme market events.

The current value of the APC is specified in clause 3.14.1(a) of the NER and is currently set at \$300/MWh in each NEM region – a level that has remained unchanged since May 2008.

It is important to note that the National Gas Rules has a corresponding price threshold and administered price cap regime, with the current price cap for gas markets set at \$40/GJ.

#### **3.2 Recent market events**

Over the period from 12 June 2022 through to 14 June 2022 wholesale electricity prices in each of the mainland NEM states reached the cumulative high price threshold, triggering the \$300/MWh APC.

However, following the imposition of administered pricing, a forecast supply shortfall

---

<sup>2</sup> The APC also acts as the administered floor price which is set at the negative of the value of the APC and represents the lower threshold that can be reached in any dispatch interval and any trading interval, during an APP.

was experienced.

As a result, AEMO was required to direct market participants back to service to ensure the system remained in supply/demand balance. On 14 June 2022, AEMO was required to direct 5GW of generation through direct interventions.

At 14.05pm on 15 June 2022, AEMO announced the suspension of the NEM Spot Market. This was activated as AEMO 'determined that it is necessary to suspend the spot market in all regions under the NER clause 3.14.3(s)3) because it has become impossible to operate the spot market in accordance with the provisions of the Rules'.

### **3.3 Issues with the current rule**

#### **3.3.1 The current APC does not reflect the SRMC of generators in the NEM**

An important factor in setting the APC is assessing the typical short run marginal cost (SRMC) of generators in the NEM. If the APC does not allow generators to cover their SRMC, then a generator acting rationally would not operate during APC periods to avoid losses.

Without generators offering at their SRMC, the dispatch schedule would not reflect the least cost to supply.

Historically, gas generators and particularly OCGTs have played an important role in helping to meet demand during times of scarcity. For gas-fired generators, fuel costs account for most of their SRMC.

Global commodity prices have changed such that the SRMC of black coal and gas generation are close to or above the APC for those generators that are more exposed to current fuel spot prices.

Specifically, since the commencement of LNG exports in 2015 the domestic gas price has become increasingly linked to the international prices for LNG. This has led to greater volatility and a higher overall average gas price which has not been reflected in the APC.

The key purpose of real time energy markets is that they schedule least cost generation for dispatch, ensuring least cost for market customers.

In a competitive market, generators have an incentive to bid at their marginal cost. If they bid a higher price they risk not being dispatched and therefore not receiving any revenue. If they bid a lower price, they lose money on the electricity they produce. This allows the dispatch engine to schedule the least cost generators, minimising the total cost.

However, if the APC is too low, generators cannot bid at their marginal cost, and therefore the dispatch engine cannot find the least cost. Instead, the market operator must determine, without price information, which generators to dispatch and generators may seek additional compensation. The operator may also pay generators the administered price, regardless of whether there is a periodic excess, for example, during the middle of the day.

Additionally, end use customers may be exposed to the cost of these compensation claims; whereas their retail contracts would typically cover them where the price is able to settle at or below the administered price. The effect of these circumstances is a lack of transparency for all participants and a dysfunctional outcome for operators, participants and consumers alike.

### **3.3.2 There is misalignment between the gas and electricity administered price caps**

Of late, east coast prices have been at record highs across all AEMO markets. This, coupled with high gas demand driven by heating needs with colder weather and for power generation, has led to gas administered price caps being invoked from late May 2022.<sup>3</sup>

There is a material misalignment in the electricity APC of \$300/MWh and the gas APC of \$40/GJ. For example, a \$40GJ gas cost and a heat rate of around 13 or 14 GJ/MWh for an OCGT/ or an equivalent Diesel Generator leads to the requirement for an electricity APC of closer to \$600/MWh.

As seen during the recent market events, unintended consequences occur where generators need to recover more than the APC to cover their costs, as this prevents normal market settlement and outcomes.

### **3.3.3 Current fuel prices are expected to remain high**

While global commodity prices may revert to historical levels, ACCC LNG netback pricing, a key indicator for the cost of gas-fired generation in the NEM, would indicate that high gas prices are set to last for the balance of 2022, and potentially to mid-2024.

This will likely see further periods where average prices over seven days are high, thereby challenging the CPT of \$674/MWh over any seven-day period.

### **3.3.4 Without changes to the APC, the NEM may move in and out of administered pricing for some time**

Without immediate changes to the APC, the NEM may move in and out of administered pricing repeatedly over the coming 12 - 24 months leading to continued challenges to the normal operation of the market, reliance on the intervention's framework (including Directions) and the need for ongoing compensation claims. Left unaddressed, these impacts will not deliver outcomes in the long-term best interests of consumers.

## **3.4 Potential impact to other rules**

While the primary focus around an increase to the APC may be current and expected gas costs, Alinta Energy considers that, as part of making a rule, consideration may need to be given to:

---

<sup>3</sup> Gas administered prices were applied after the gas retailer of last resort event involving Weston Energy and the various markets reached the cumulative high price thresholds.

- The CPT mechanism, given the relationship between the APC and the CPT;
- how the CPT/APC impacts the recovery of opportunity costs for storage, particularly longer-term storage; and
- The impact of any potential changes to the gas APC over the timeframe, on any new level of electricity APC.

## **4. Proposed rule**

### **4.1 How the proposed rule will address the issues**

The purpose of the APC is to cap participant exposure to the potential of what could otherwise be high prices during an APP, while maintaining incentives for participants to supply energy.

The proposed rule will address the significant increase in the typical SRMC of generators in the NEM driven by recent high commodity prices which are expected to be maintained for a sustained period.

By making this rule a more predictable, transparent and stable market environment will likely eventuate by:

- Providing adequate incentives for generators to bid capacity as normal into the market and minimise the likelihood of triggering further compensation claims whilst still protecting energy purchasers and the financial stability in the market in response to extreme market events; and
- Avoiding, as far as possible, the strains on the market operator and the dysfunction which led to a market suspension.
- Allowing generators to bid at their marginal cost which enables AEMO to schedule dispatch based on least cost.; and
- Providing utility-scale energy storage operators with a greater ability to deliver a range of market services.

### **4.2 How the proposed rule contributes to the National Electricity Objective**

The NEO is to promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity with respect to:

- price, quality, safety, reliability, and security of supply of electricity; and
- the reliability, safety, and security of the national electricity system.

The proposed rule will improve incentives for generators to bid capacity as normal into the market which will help contribute to the NEO by promoting efficient operation and use of electricity services for the long-term interest of consumers with respect to pricing, dispatch and the reliability of the national electricity system.

## 5. Expected benefits and costs of the proposed rule

In summary, while the benefits to the operation of the wholesale market, in terms of providing robust incentives for generators to bid capacity as normal into the market and avoiding the need for the compensation regime should be weighed against the potential impacts on the contract market and to the retail sector from a higher APC, it is expected that the net impact of the proposed Rule would be significantly positive.

The higher APC mitigates the risks of longer-term capacity scarcity, compensation claims and market suspensions which would fundamentally undermine the contract market and retail sector, resulting in higher costs to consumers if sustained

### 5.1 Expected benefits

Alinta Energy expects the benefits of the proposed rule are:

#### **Enabling normal market operation and settlement**

By reflecting the actual SRMC of gas and coal generation in the APC:

- there will be adequate incentive and sufficient value for generators to bid capacity as normal into the market.
- Bidding behaviour is more likely to consistently reflect actual cost positions. Cost reflective bids provide market participants and AEMO with price signals to enable participants to value fuel positions through time and so enable effective dispatch of the market by AEMO.
- Promoting cost reflective bidding by other dispatchable generators, enables battery and hydro storage providers to more appropriately value stored energy in their market bids.
- AEMO can schedule generation and storage based on least cost dispatch.
- Compensation processes under the APC are less likely to be needed over large number of trading intervals.
- Provide for a better alignment of the electricity APC with the gas APC which should minimise any perverse outcomes caused by the misalignment.

#### **Mitigating the risk of a systemic financial collapse of the electricity industry during an extreme market event**

An increased APC will:

- Facilitate generator cashflow management by removing or minimising the risk of delays to recovery of costs and potential mismatch to when they are incurred.
- Lower the probability and impact of volume risk faced by generators with contracted positions when faced with an APP event.
- Ensure that scarcity pricing, and hence retailer bankruptcy risk, is still managed by the price cap.

## **Protecting the long-term interest of consumers with respect to pricing, dispatch and the reliability and security of the national electricity system**

- Compensation costs are recovered from retailers using energy in the time period that the administered pricing applies. Higher prices under an increased price cap would see more of the cost of high-priced events covered by retailers' hedge contracts and therefore less to pass on to customers.
- By enabling normal market operation and settlement AEMO is able to schedule generators based on least cost and is less likely to have to intervene in the market which provides for a more secure, reliable and efficient system.

### **5.2 Expected costs**

Alinta Energy expects the costs of the proposed rule are:

- A change to the APC would impact existing OTC and ASX contracts and have implications for future contract structures and prices. There would be risks to generators and energy users, and changes to the incentives for market participants to offer and purchase energy derivatives. For example:
  - Given that market costs have increased as a result of the APC event, generators may be less willing to offer hedges, whereas retailers may be more incentivised to purchase hedges. This would apply upwards pressure on the value fixed price futures contracts, and in turn impact retailers' credit support arrangements.
  - On the other hand, in providing the incentive for generators to bid capacity as normal into the market, an increase in the APC will ensure that normal market operation is maintained. This is likely to reduce underlying spot prices during APP periods and therefore provide a downwards pressure on these derivatives.

On balance, we would expect a reduction in the overall cost of electricity to retailers and end-users through extended periods of high commodity prices, compared to the status quo.

- There could be an impact on existing OTC contracts. OTC caps are generally based on a \$300 price. This is the same for ASX cap futures. It is likely that this price point has been chosen because of the APC- i.e., the seller of the cap can be certain that the CPT and APC will mitigate its exposure under the cap. Changing the value of the APC changes the exposure of sellers under caps and the value of the product.
- ASX contracts however reference AEMO prices, and hence it is not anticipated existing ASX contracts would be impacted by any change to the APC.
- Changing the APC may create some uncertainty in the OTC market, for example in relation to market disruption clauses which can include material change formulas related to the specified price (the spot price on which the derivative is based).
- Generators with short positions against existing ASX contracts would need to post additional funds against those positions if the change in the APC was to result in an increase in forward contract prices. This may present issues for

generators who are already cash-constrained. However, this issue may not be as material as the overall increase in funds already required to manage increases in contract prices due to higher fuel costs.