

7 July 2022

Reliability Panel  
c/- Australian Energy Market Commission  
GPO Box 2603  
Sydney NSW 2000

Electronic Submission

### **Draft Report 2022 Review of the Reliability Standard and Settings**

Snowy Hydro welcomes the opportunity to comment on the matters raised in the Draft Report 2022 Review of the Reliability Standard and Settings (Draft Report).

#### **Market Price Cap and Cumulative Price Threshold**

Snowy Hydro agrees with the Draft Report that there is a misalignment between existing levels of Market Price Cap (MPC) and Cumulative Price Threshold (CPT) and the levels required to support investment consistent with the reliability standard. In particular, Snowy Hydro agrees that an optimal MPC will be in the range from \$21,000/MWh to \$29,000/MWh.

For the reasons set out in our previous submission, Snowy Hydro considers that an MPC of \$22,500/MWh would be sufficient to incentivise additional investment in dispatchable capacity. However, Snowy Hydro supports an increase in MPC to any level in the proposed range of \$21,000/MWh to \$29,000/MWh. An increase of that magnitude will improve resource adequacy in the NEM without creating unmanageable financial risk for Market Customers. It is also consistent with Snowy Hydro's submission to the Reliability Panel, which recommended the Panel model an MPC between \$20,000/MWh to \$30,000/MWh. As mentioned in that submission, the Reliability Panel should model the impact of adjusting the MPC on the traded price of \$300/MWh cap contracts (\$300 Cap), given that, in practice, the price of \$300 caps serves as the proxy for new investment in dispatchable assets.

The Reliability Panel's assessment of reliability settings is particularly important given current concerns over resource adequacy. The Panel has an important educational role in making clear that increasing electricity costs have been driven by the rising cost of energy, not capacity, and that adjusting the MPC is a more cost-effective means of improving system reliability than a capacity mechanism. It is transparent, administratively straightforward and would preserve the NEM's energy-only structure. In contrast, the ESB's currently-preferred design for a capacity mechanism involves a complicated system of centralised procurement by AEMO. The experience of the RERT demonstrates that this form of capacity procurement is expensive.

It is worth emphasising that energy-only markets do not produce more volatile consumer energy price outcomes compared to capacity markets, with the potential exception of market customers who elect to not hedge their exposure. Little evidence has been adduced justifying the need for a capacity mechanism, only unsubstantiated claims that

it would improve investment certainty (a view not shared by investors themselves) and the fact that a capacity market has been adopted in some other countries. Needless to say, these are not compelling reasons.

Snowy Hydro considers that the level of the CPT should also be increased, at a minimum by maintaining the existing ratio with an adjusted MPC (ie. 7.5 hours). Increasing the MPC to \$22,500/MWh but retaining a 7.5 hour duration suggests a CPT of \$2,025,000. Snowy Hydro also supports consideration of an increase of up to 12 hours in order to improve incentives for longer duration storage, to the extent that the Reliability Panel can establish through its modelling that doing so will not create systemic risk for market participants.

### **Administered Price Cap**

Snowy Hydro supports an increase in the Administered Price Cap (APC). Based on the recent traded price of natural gas, the existing level of the APC (\$300/MWh) is lower than the short-run marginal cost (SRMC) of generation from open-cycle gas turbine power stations (OCGT), and dispatchable generation which shadows the cost of OCGT. As recent experience demonstrates, capping market prices below SRMC increases the risk of supply shortages, even where provisions exist for parties to claim compensation. To avoid this scenario in future, Snowy Hydro considers that the level of the APC should be linked to a market metric rather than set as a static value, which can then be reflected by participants in cap contracts.

Snowy Hydro suggests the APC could be calculated as follows::

- the administered price cap for gas (\$40/GJ) multiplied by a deemed heat rate for OCGT of 12 GJ/MWh = \$480/MWh; or
- the average spot price for the previous 12 months multiplied by five; at present, approximately \$630/MWh.

Although Snowy Hydro supports an increase to the APC, the timing in which an adjustment should take effect is not straightforward. Fuel supply and generator contracting arrangements will be important considerations. Snowy Hydro is considering the optimal timing for a change to the level of the APC.

### **Level of Reliability Standard**

Snowy Hydro supports the current reliability standard and considers that the NEM should not face two standards as it does at present. The NEM needs consistency and this is best achieved through a NEM-wide reliability standard determined by the Panel. Inconsistent jurisdictional standards have the potential to confuse and dilute investment signals.

Snowy Hydro appreciates the opportunity to respond to the Reliability Panel on the matters raised in the Draft Report.