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Craig Oakeshott
ERC0347 Project Leader
AEMC
Submitted via website

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Dear Craig

**RE: Amending the administered price cap rule change – consultation paper**

Thank you for the opportunity to provide feedback on the Amending the administered price cap rule change – consultation paper.

Enel X operates Australia's largest virtual power plant[1] with over 350MW of flexible assets under management across more than 150 commercial and industrial sites. We were the first registered Demand Response Service Provider (DRSP) and work with commercial and industrial energy users to develop demand-side flexibility. This flexibility is offered into the NEM's energy and ancillary services markets, the RERT mechanism, and to network businesses.

Enel X does not support the rule change with this submission setting our position as to why it does not promote the long-term interest of consumers. It also offers alternate actions to that proposed in the request for the AEMC's consideration.

Enel X is concerned the rule change proposal will have a significant impact on existing cap contracts whilst not addressing the issues with incentives during Administered Price Period (APP) and because of this, not being in the interest of electricity consumers. We have three concerns with the proposal will:

- not, in our opinion given the evidence provided to date, have an overall beneficial impact on reducing overall consumer costs.
- not address all root causes of the issues faced during June's APP, which also includes market confidence in compensation processes rather than just the level of the administered price cap (APC) itself.
- have a disproportionally negative impact on sellers of existing cap contracts when they are not all a uniform group of peak thermal plants.

We consider the rule change as proposed in the long-term interest of consumers because of these points. Instead, we consider the AEMC should either:

[1] Bloomberg NEF, December 2019.

1. **Determine no rule and undertake a fundamental review of the form and level of the APC** as recommended in the Reliability Panel's Reliability Standards and Settings Review – Final report.
2. Make a **more preferable rule** that aims to **improve market confidence in compensation processes immediately** and if any APC increase is deemed necessary, **only increase the APC in Q4 2023 at the earliest** to provide sufficient time for the existing cap trades (ASX and/or OTC) to be renegotiated/managed.

## Fundamental and considered review of Reliability settings required to avoid unintended consequences

Enel X considers the form and level of the APC inappropriate for the future NEM we are transitioning towards with high VRE penetration that has low SRMCs coupled with price arbitraging storage assets. Current market conditions and trends show that participants that use dynamic market prices to create value through arbitrage, or have highly variable short-run marginal costs face weak incentives under a $300/MWh APC.

These issues should be addressed through significant industry consultation with sufficient time for participants to make informed decisions regarding hedge contract strategies and positions. This is currently occurring through the AEMC and Reliability Panel's processes to set the FY25-28 NEM reliability standard and settings. Enel X notes these are the most suitable avenues for such a change to be made than through this rule change request that would affect businesses who have made good faith investments – namely in $300/MWh strike price cap contracts.

This rule change is being undertaken in an expedited process, which struggles to fully appreciate all unintended consequences of any potential final rule – despite, we note, the AEMC's best efforts. The request looks to make changes to market settings in reaction to market conditions that are no longer prevailing and where a convolution of several unprecedented events occurred simultaneously.

Instead of being reactionary, the AEMC should continue to undertake a more fundamental review of APC – as recommended by the Reliability Panel – and should maintain the current settings to give market certainty by maintaining the value of all secondary market cap contracts. As discussed further below, the level of the APC is not the only mechanism available to the AEMC to improve market operation under APP but is the lever that will lead to increased costs for consumers.

Additionally, the consultation paper raises the question of compensation being an unhedgeable cost for retailers and consequently being minimised. The Reliability Panel and AEMC knew these costs may temporarily increase towards the end of the FY21-24 period when making its recommendation to maintain a $300/MWh APC. It stated "The Panel recognises that fuel prices may exceed the $18/GJ assumption used in this review. However, we would consider such price increases to be temporary rather than structural. The Panel proposes to adopt the approach … that volatility in fuel prices during the review period should be addressed through the compensation mechanism."[2]

[2] Reliability Panel, *Reliability standard and settings review 2018: Final Report*, 30 April 2018, p. 92

We understand that such volatility of the proportions may not have been perceived as credible by the Reliability Panel at the time, but it is clear evidence that the compensation process was there for this exact reason. To be a failsafe for temporary cost increases in input fuel costs. The cost of gas has already reduced since June and while it may be at a higher price for prolonged periods, we do not consider its increase can be classified as 'structural'.

Therefore we note a more pragmatic and economic outcome to address the issue is for the government(s) to make partial or full payment of these compensation costs. Shifting the cost – either through reducing the value of contracts or the viability of the price risk between $300-$600/MWh during an APP – to existing cap contract sellers is unfair and does not align with best practice regulation principles.

If the AEMC determine some change should be made, we consider the following two points should be accounted for in its decision.

### Priority for immediate action to increase market confidence in APP compensation processes

Enel X judges the best solution is to amend APP compensation processes in two ways:

1. Change responsibility for compensation claims from AEMC to AEMO.
2. Remove opportunity costs from APP compensation claims.

We acknowledge the analysis carried out by the Commission about the SRMC of the existing thermal fleet. AEMC states that the current level of the APC does not allow generators to bid in a cost-reflective manner – we consider this incomplete as the APC comes in ex-post and so all participants should maintain cost-reflective bids and claim compensation for any lost revenue due to the APC.

We note analysis of the rule change in both the request and the consult paper does not fully appreciate participants' incentives to operate during APP is the APC plus compensation, not just the APC itself. The APC is a key pillar of the wholesale market that the secondary contract market establishes itself from whereas the compensation available is not critical to existing contracts. The cap is there to protect the market and consumers while the compensation is there to retain incentives for participants to maintain cost-reflective bids even if they exceed $300/MWh.

Therefore, this is where we feel the best and most immediate solution lies – in improving the APP compensation process to increase market confidence during APPs to continue to operate as envisioned.

Firstly, removal of opportunity costs and having clear direct cost calculations that are transparent and quickly assessed and paid. Further, these costs are not available for compensation during other periods of administered pricing, such as market suspension or to directed or affected market participants when AEMO intervenes in the NEM.

Additionally, transferring responsibility from the AEMC to AEMO for these claims should be considered. The compensation process operated by AEMO for directions and market intervention, and market suspension are well known, are integrated with settlement processes and are good examples that can be replicated in the NER and practised quickly and efficiently for any future APPs.

The benefits of such a change would:

- lower potential total compensation costs by removing opportunity costs from potential compensation claims
- lower administrative costs as AEMO already have processes in place to provide such compensation services whereas AEMC are bespoke and ad-hoc
- improve generator certainty as incentives to operate in APP are clearer with increased transparency and clarity on potential compensation above the APC for operation
- the solution does not affect the secondary contract market such as changing the level of the APC.

### Any increase to APC should not commence until Q4 2023 at the earliest

If any APC increase is deemed necessary, Enel X consider the APC should only increase in Q4 2023 at the earliest. This, in conjunction with compensation process improvements, will maintain the security of the system without jeopardising the majority of existing cap contract positions or providing just an opportunity for cap contract sellers to adjust their positions.

Internal Enel X analysis of cap contracts traded on the Australia stock exchange (ASX) shows a clear drop off in contracting in 12 months.[3] This is most pronounced in Victoria, as an example, where roughly 600 cap contracts for the existing quarter (Q3 2022) are down to ~100 contracts in Q4 2023. This contracting cycle, or hedge book build, is evidenced in both the AEMC's own Price trends methodology and the AER's Default market offer price determinations.

Given such a trend, Enel X consider it prudent to commence any change to the APC from Q4 2023 at the earliest. This should minimise its impact on existing cap contracts as there are fewer traded than any earlier commencement date. Additionally, this gives any trader who wishes to adjust their position ample time to do so, either through the ASX or through a more cumbersome over-the-counter type bilateral contract agreement.

Please contact Carl Hutchinson, Head of operations – APC, for any queries on this submission at carl.hutchinson@enel.com.

Regards

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[3] ASX scape taken on 19th Aug 2022 with analysis and reflections made here to the best knowledge of Enel X staff.