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Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Dear Ms Collyer

Amending the administered price cap, Directions Paper

AEMO welcomes the opportunity to provide a submission on the Directions Paper on the proposal to increase the administered price cap (APC) from $300/MWh to $600/MWh, published on 29 September 2022.

AEMO considers the rule change to be an effective interim measure to address the narrow problem of the APC being insufficient to pay for generating units' short run marginal costs (SRMC). This measure will significantly reduce risks to power system reliability and security by incentivising generators to continue making supply available during administered pricing, despite higher fuel prices.

AEMO supports the key policy position set out in the Directions Paper, which is a temporary increase in the APC from $300/MWh to $600/MWh until no later than 1 July 2025 (when any change to the longer-term setting of the APC would be made following the AEMC's consideration of the Reliability Panel's rule change request). AEMO also supports the proposal to maintain the CPT at its current setting at this time.

AEMO agrees with the Commission's proposal to implement the rule change as soon as practicable and commits to working closely with the AEMC on implementation.

Any enquiries to this submission can be directed to Kevin Ly, GM Reform Development & Insights at kevin.ly@aemo.com.au.

Yours sincerely,

Violette Mouchaileh
Executive General Manager – Reform Delivery

Attachment – responses to the consultation questions

Question 1: Temporary level of APC

1. Do you agree that the proposed temporary level of $600/MWh would facilitate improved market operation and greater security and reliability during an APP?

As stated in our initial submission on the rule change, AEMO's position is that increasing the APC would be the best solution to the narrow problem of insufficiency of the current APC to pay for the prevailing short run marginal costs (SRMCs) of many generators. Increasing the APC would minimise the operational challenges that led to the June 2022 market suspension. It is expected that a higher APC would have fewer generators withdraw capacity during an administered pricing period. During the June events, when administered pricing commenced, many generators withdrew their capacity from the market, AEMO had to direct generating units to remain available, and the impact of multiple intervention constraints meant it was impossible to operate the spot market which ultimately led to AEMO suspending the market.

2. Would a level greater than or less than $600/MWh facilitate improved market operation security and reliability during an APP? Where different, please provide reasons for your answer?

As indicated in our initial submission[1], $600/MWh is better than $300/MWh and represents an effective interim measure. The opportunity for refining the APC, possibly using a formula linked to prevailing commodity prices, can follow this process, including considering this when the AEMC considers the Reliability Panel price setting rule change.

Question 2: Level of the CPT

1. Do you agree that the level and escalation methodology of the CPT should remain unchanged in this rule change?

AEMO agrees with most stakeholders and the Commission that there should be no temporary change to the level or escalation methodology of the CPT except through the existing annual mechanism under clause 3.14.1(d) to (f) of the National Electricity Rules (NER). AEMO considers the current rule change should be focused on the insufficiency of the APC and on addressing this problem.

Given the CPT is calculated using prices capped by the Market Price Cap (MPC), and the MPC is sufficient to pay generators to dispatch, AEMO does not consider it necessary to amend the CPT on this basis. Provided dispatch operates reasonably efficiently during an administered price period, it matters little how frequently this applies.

Although higher commodity prices will increase weekly average prices and therefore reduce the buffer in accumulated prices before the CPT is breached, the FY22 CPT was a weekly average price of $674/MWh, which is above the proposed APC of $600/MWh.[2] It is also worth noting that high commodity prices were not the only driver of the events of June 2022. The high fuel costs were exacerbated by very cold weather and generating unit and some transmission outages.

2. Do you agree that any change to the method of calculation of the cumulative price, is a matter best left to the Reliability Panel?

The Reliability Panel has recommended changes to the CPT to take effect through rule changes for the period after 1 July 2025.[3] The Panel's final recommendation is for a progressive adjustment in the level of the MPC and CPT to achieve an MPC of $21,500/MWh and a CPT of $2,193,000 (corresponding to 8.5 hours of market

[1] AEMO Submission to the Consultation Paper 2 September 2022 pp3-4
[2] AEMO Submission to the Consultation Paper 2 September 2022 p6
[3] AEMC APC Directions Paper p1

prices at the recommended MPC) (in $2021) by the end of the review period (by FY 2028).[4] The Panel considers this will "enable the market to achieve and send efficient price signals, and support the efficient operation of, and investment in electricity services over the long run, while also limiting market participant exposure to price risk." The Panel recommends three annual changes to the current MPC and CPT in order to gradually transition to the recommended level by FY 2028.[5]

While AEMO does not comment on these recommendations specifically, AEMO considers that changes to the method of calculation of the CPT are best left to the Reliability Panel and the formal rule change process. This process will provide an opportunity for stakeholders to explore whether changes to the method of calculation of the CPT may have any impacts on the contracts market.

Question 3: Timeframe of the APC

1. Do you agree that the proposed temporary level of $600/MWh should apply as soon as practicable until 1 July 2025?

In relation to timeframes, AEMO supports the Commission's conclusion that the increased APC should be implemented as soon as practicable. If the AEMC makes a final determination in favour of the current rule change, AEMO will liaise with the AEMC to ensure that the APC of $600/MWh is implemented as soon as possible, and in compliance with AEMO procedures and change processes.

AEMO agrees that the temporary APC of $600/MWh should remain in place until no later than 1 July 2025, when the APC should be that recommended by the Reliability Panel and as determined through the rule change process. AEMO notes that in addition to its recommendation that the APC be increased from $300/MWh to $500/MWh from 1 July 2025 to 30 June 2028,[6] the Panel also recommended a follow-up review to consider other APC settings such as a dynamic value linked to gas prices.[7]

The processes outlined above could result in multiple changes to the APC level and calculation methodology in the coming years. AEMO considers that maintaining an APC of $600/MWh until 2025 would provide more stability and certainty to the market than the 12-month period originally proposed.

Question 4: Impacts

1. Do you agree that the impact of a change on the level of the APC for a temporary time period will have a relatively minor impact on the contract market based on observed price levels during June 2022's events?

AEMO agrees that the impact of the rule change on existing and future hedging arrangements would not be significant, given it is limited to adjustments to pricing expectations accounting for higher APC levels during APP periods (subject to the expectation of their future recurrence).

3. Do you agree that the impact of a change on retailer and end user costs is likely to be positive, provided retailers and end users are adequately hedged? If not, please state reasons for your answer?

AEMO agrees with the Directions Paper in that retailers and consumers will benefit from a higher APC due to reductions in unhedgeable compensation costs. As noted, many compensation costs will need to be passed through to consumers, a situation which would have been prevented if the APC had been sufficient to cover generating units' SRMCs and avoid the consequential payment of administered pricing compensation. AEMO agrees that it is likely a lower APC would favour an unhedged retailer whereas a high APC would favour a prudently hedged retailer.

[4] Reliability Panel AEMC Final Report 2022 Review of the Reliability Standard and Settings 1 September 2022 p61
[5] Reliability Panel AEMC Final Report 2022 Review of the Reliability Standard and Settings 1 September 2022 p66
[6] Reliability Panel AEMC Final Report 2022 Review of the Reliability Standard and Settings 1 September 2022 p85
[7] Reliability Panel AEMC Final Report 2022 Review of the Reliability Standard and Settings 1 September 2022 p86

AEMO supports the Direction Paper's conclusion that a higher APC would likely facilitate more economic dispatch, which would reduce costs for consumers compared to a counterfactual at the current APC where AEMO would direct generators to dispatch and require compensation.

AEMO notes the hedging position of retailers is only relevant to the short run effects, and who pays. In the longer run, absent such contracts, administered pricing cannot be below short run production costs to any great degree. This is because rather than simply reducing the producer surplus, an insufficient APC directly imposes costs that must be subsidised by producers. Without the ability to fund that subsidy, producers would withdraw, and the market would cease to function. It is unlikely a compensation arrangement can solve this problem adequately if widespread.