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By online submission

Review of the form of the reliability standard and the APC

Alinta Energy welcomes the opportunity to provide feedback to the Reliability Panel's issues paper. This submission focuses on the form of the APC in the NEM.

Governance arrangements for market price setting reviews may have contributed to the events of winter 2022

After the market suspension in winter 2022, Alinta Energy requested that the AEMC pursue an urgent rule change to increase the level of the APC. The case was made that the level of the APC was not reflective of short run marginal costs (SRMCs) of gas-fired generators and needed to be increased to allow the market to function. While volatility in the SRMC of marginal generators was identified as a risk in the Panel's 2018 reliability standard and settings review (RSS), the events that led to the NEM and regulated gas markets being simultaneously administered for an extended period could not have been reasonably foreseen and are not necessarily indicative of a failing in the design and governance of the NEM; however, it seems likely that the fragmentation of market price setting review processes across the markets contributed to the failure to identify the relationship between the gas market APCs and the NEM APC.

The relationship between gas market APCs and the NEM APC was subsequently addressed and considered in the 2022 RSS, however the review process was complicated by the fact that the gas market parameter review is conducted by a different body (AEMO) and in series, six months after the RSS, rather than in parallel.

The recent, and impending, closure of coal fired generation capacity has driven a greater need for gas-fired generation in the NEM, particularly during periods of high electricity demand. As a result, electricity and gas markets are now more interrelated than ever. Therefore, it is essential to ensure that price settings are appropriately aligned across these markets; while this is outside the scope of the Panel's review, Alinta Energy recommends the alignment of governance arrangements for changes to market price settings across the NEM, STTM and DWGM.

Commentary on options for the form of the APC

The purpose of the APC is to limit financial risk of consumers to extended periods of volatility. It should be set at a level high enough to allow trade at the expected SRMC of the market's marginal generators. The key feature for an APC to be effective is that it should be predictable. To the extent that the APC is not predictable, market participants will need to mitigate any additional risk via forward contracting instead or absorb the risk; both of which are likely to lead to an increase in costs to consumers in the long run. On the other hand, investors in generation are likely to make conservative forecasts accounting for the impact of the APC on future revenues. Thus, an APC that is not predictable is arguably worse than no APC at all, as it provides no benefit to market participants while potentially limiting efficient pricing signals.

1. Current form of the APC

The current form of the APC is simple and allows for the greatest possible level of certainty for market participants. While other forms of APC may have avoided the need for the urgent rule change in 2022 (an excessive reliance on ad hoc rule changes also being undesirable as such changes cannot be predicted at all) the possibility of such black swan events that necessitate a short-term adjustment to the framework will always exist, and there is significant value in simplicity to participants in the forward markets.

2. Indexing to the gas APC

This option provides for a similar level of certainty as the current form, given that gas APCs are also static and reviewed at the same frequency and with the same lead time as the current form. It raises some questions about which gas market APC should be used in the unlikely event that the DWGM and STTM APCs diverge, but potentially helps to address the current issue with the timing of the price setting reviews for the regulated gas markets and the NEM. With this option, the Panel could set the level of the APC in the NEM based on a gas market APC, ensuring a sufficient spark spread without concern for a subsequent adjustment to the gas market APCs. However, it should be noted, as above, that a more direct means of solving this issue is to align the market price setting review processes across these markets.

3. Dynamic linking to a price series

This option does not provide sufficient certainty to be relied upon. It also suffers from the issue that the chosen price series may not be relevant during the particular circumstances of a market event.

4. Consist of two fixed levels, with an increase triggered by defined circumstance

Without further definition it is hard to comment on the viability of this option, however it is problematic in that the trigger may not be predictable.

5. Indexing to CPI

This option provides sufficient certainty to market participants and has the added benefit over the current form of the APC by aligning it with the form of the Market Price Cap and the Cumulative Price Threshold, ensuring that these market price settings do not decline in real terms over time.

Of the above options, Alinta Energy considers that 1, 2, and 5 are the most likely suitable candidates for the form of the APC based on the information available in the Panel's issues paper.

If you would like to discuss this further, please contact me at hugh.ridgway@alintaenergy.com.au.

Yours sincerely,

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