26 June 2023

Australian Energy Market Commission

Submitted via the AEMC website

Dear AEMC,

Amendment of the Market Price Cap, Cumulative Price Threshold and Administer Price Cap

Hydro Tasmania welcomes the opportunity to respond to the Consultation Paper: *National Electricity Market (Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap) Rule (ERC0353).*

This is a critical issue for the sector and for the NEM energy-only market as a key driver of future investment. Hydro Tasmania participated in the 2022 consultation by the Reliability Panel. We believe that their analysis (carried out by IES) and engagement with stakeholders was transparent and robust. As a result, Hydro Tasmania supports the recommendations of the Reliability Panel and the proposal to reflect those through this rule change request. Hydro Tasmania is also a member of the Australian Energy Council and Australian Financial Markets Association. We support the views put forward in their submissions.

Context and criteria for this rule change

The consultation paper appropriately reflects on the circumstances in which this rule change is occurring, namely: the transition of the electricity sector; the need for investment in additional flexible capacity; and the pressure of recent electricity cost increases on consumer bills. The five criteria that the Commission will use to assess this rule change are also appropriate: *Reliability; Outcomes for consumers; Principles of market efficiency; Principles of good regulatory practice; and Emissions Reduction.*

The NEM is going through a significant transition to higher shares of renewable generation. Both the resource mix and the nature of future reliability challenges are changing rapidly. The market price settings need to be well calibrated to ensure that they underpin timely investment in the range of technologies and resources needed to maintain reliability and security. A key part of this is the need for long duration storage to firm and balance the output of variable renewable generation. As we wrote in our March 2022 submission to the Reliability Panel:

> *"The current Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Period (APP) forms a natural hedge for sellers of risk management derivatives. There could be a risk that these settings mute the investment signals for longer duration capacity in favour of shorter term capacity that will benefit from the protection offered by the artificially capped MPC, CPT and APP. Hydro Tasmania recommends further consideration of this issue*

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and the implied investment signals against the resource mix needed for a reliable, secure and affordable low emissions system."

Hydro Tasmania is encouraged that the Reliability Panel considered this issue and included an increase to the Cumulative Price Threshold in their final recommendation.

The Reliability Panel's final report indicated that (according to modelling):

> *"the proposed increase is the minimum level required to support investment in generation, storage and demand response needed to avoid exceeding the reliability standard in light of thermal generator retirements after 30 June 2028."*

Hydro Tasmania believes that this rule change addresses the first four principles outlined by the AEMC. It provides a balance of *outcomes for consumers* against the *principles of market efficiency, good regulatory practice,* and the need to ensure *reliability* in the NEM going forward.

At this stage, we are unclear how the incorporation of an emissions reduction objective in the National Electricity Objectives may impact this rule change. The Reliability Panel's analysis was conducted against the assumption that the marginal new entrant in NSW will be OCGT plant. Given the implications of policy approaches such as the national Capacity Investment Scheme (which will only support renewable capacity) and NSW Energy Roadmap, other new entrants could be considered under an emissions reduction scenario. At this stage however, there may not be sufficient evidence to deviate from the changes put forward in this rule change.

With respect to the role of federal and jurisdictional reliability schemes, Hydro Tasmania believes that these approaches will be complementary. This is because additional investment is likely to need both: price settings that appropriately value dispatchable and flexible generation and storage (provided by the MPC and CPT); and policy frameworks or mechanisms that de-risk those investments (e.g. the proposed federal Capacity Investment Scheme). This is particularly relevant to long lead-time investments such as pumped hydro energy storage. These assets will be critical to provide firming and reliability in the future NEM but face additional investment challenges due to the risk of market shifts (or additional government interventions) between final investment decision and commissioning. Underwriting, or other policy support, can mitigate this risk and ensure those investments are delivered at a time that supports NEM reliability and resilience.

Administered Price Cap (APC)

Hydro Tasmania supports the continuation of the current $600/MWh APC. The market has already adjusted to this new level and leaving the APC at this level can ensure consistency for market participants. There would need to be a clear rationale for a further change.

Further comment on the consultation paper questions is included as Attachment A.

If you wish to discuss any aspect of this submission, please contact me on (03) 8612 6443 or at Colin.Wain@hydro.com.au).

Yours sincerely,

Colin Wain

Manager Policy Development

Attachment A – Hydro Tasmania's responses to the consultation paper questions

QUESTION 1: QUESTIONS ON THE MPC AND CPT

Do stakeholders:

- agree that existing MPC and CPT are too low to support marginal new entrant investment in the NEM?
- have any feedback on Panel's recommended MPC and CPT? Do its recommendations effectively address the identified issues?
- agree with the rationale behind the Panel's recommendation including to:
  - limit the extent of change in the review period given that the Panel's modelling indicated further increases may be necessary in future review periods
  - provide a progressive transition over the review period
  - incrementally enhance incentives for storage investments, and
  - support contract market outcomes and minimise systemic risk.
- Do stakeholders have any feedback on the costs identified by the Panel?
- Do the benefits of the proposed changes warrant the costs to consumers?
- Are there any other considerations on the Panel's recommendation on the MPC and CPT the Commission should consider in its rule change assessment?

- Hydro Tasmania agrees with the Reliability Panel's analysis that the current MPC and CPT are insufficient to drive investment in new entrant capacity in the NEM.
- As noted by the Reliability Panel, the proposed increases are likely to be the minimum required to encourage further investment and are calibrated to support new-entrant OCGT in the NSW region. It is unclear whether this change is sufficient to support investment in an efficient mix of technologies over the forecast period.
- Increases to MPC and CPT will strengthen the incentive for participants to reduce risks through contracting. During its review, the Reliability Panel observed that: *"it is not necessarily the case that a lower MPC will lead to lower average consumer costs. Similarly, a higher MPC may not necessarily lead to higher consumer costs."*
- A progressive transition over the review period is sensible, however, we note that further changes may be needed for later periods. Future settings will also be informed by the AEMC's 2023 '*review of the form of the reliability standard and APC*'.
- The future NEM will need a range of flexible capacity and storage durations. In particular, long duration energy storage will be needed to address potential 'high impact, low probability' events - which will increase in frequency, depth and duration with the growth of weather dependent energy resources. Increases to MPC and CPT will assist the investment case for long duration storage and capacity, however, additional policies such as the national Capacity Investment Scheme (CIS) are likely needed to sufficiently de-risk long lead investment decisions and ensure they are delivered at the right time. Hydro Tasmania

believes that these approaches can be complementary and are not duplicative. The CIS is aimed at de-risking investments and is unlikely to secure investment that cannot already foresee a commercial return under the NEM's price settings.

- Appropriate market settings can ensure that spot, contract and investment outcomes are as efficient as possible and can reduce the need for unnecessary government intervention. Consumer costs will ultimately be an outcome of many factors, but seeking efficient price signals should continue to be a foundational principle. Under scenarios where there is insufficient investment, there will be a greater reliance on higher cost approaches such as the Reliability and Emergency Reserve Trader (RERT) or on reactive government interventions. These costs will also ultimately flow to consumers or taxpayers.

QUESTION 2: QUESTIONS ON THE LEVEL OF THE APC

- Do stakeholders have any feedback on applying either the Panel's recommendation for an APC of $500/MWh or Commission's APC rule change for an APC of $600/MWh over the review period? Are there any specific market impacts or considerations the Commission should be aware of?
- Do stakeholders have any feedback on the costs identified by the Panel and Commission?
- Should the level of the APC reflect expected future inflation, noting the Commission is not intending to introduce indexation arrangements?
- Are there any other considerations on the Panel's recommended APC the Commission should consider in its rule change assessment?

- Hydro Tasmania agrees that the APC should not revert to $300/MWh.
- Given the market has adjusted to the current $600/MWh level we would suggest there would need to be a clear rationale for deviating from this level. Consideration needs to be given by AEMO to the interaction between the NEM APC and gas market price settings.
- At this stage Hydro Tasmania has not formed a strong opinion on whether the APC should be indexed, however, the APC needs to continue to be reviewed over time to ensure its relevance.

QUESTION 3: QUESTIONS ON THE COMMISSION'S DECISION-MAKING FRAMEWORK AND CONSIDERATIONS

- Is the proposed assessment framework appropriate for considering the Panel's rule change request? Are there any other relevant considerations that should be included in the assessment framework?
- Are there any additional factors the Commission should consider when incorporating an emissions objective into its rule change assessment?
- Do stakeholders have any suggestions or views on the Commission's consideration of jurisdictional scheme interactions with a higher MPC and CPT?
- Are there any additional pieces of analysis the Commission should consider undertaking to assess the rule change?

- Hydro Tasmania supports the Commission's assessment framework and five key criteria.
- Legislation supporting Australia's emissions reduction target of 43 per cent and net zero emissions by 2050 was passed by the Federal Parliament in late 2022. To align with this, NEM

price settings will need to be sufficient to support investment in zero emissions capacity and storage. As described above, a reliable and secure renewable energy system will require long duration capacity and energy storage assets. As the Reliability Panel's analysis suggested, increasing the MPC and CPT sufficient to support these investments may have trade offs against potential consumer price outcomes. This is on the basis that even a very high MPC may not be easily 'bankable' if very high prices only occur every few years. Hydro Tasmania believes the interaction between market price settings and policies such as the Capacity Investment Scheme will be critical. NEM reliability will depend on this combination of approaches bringing forward investment and doing so in a timely and efficient manner. In some cases this may include assets being commissioned slightly ahead of a reliability gap as this can increase resilience to market shocks, prolonged outages or the early exit of thermal plant.