



10 May 2011

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Sir / Madam

Consultation Paper: Application and Operation of Administered Price Periods – ERC0121

The National Generators Forum appreciates the opportunity to comment on the Consultation Paper on Application and Operation of Administered Price Periods.

In reviewing the relevant issues, the NGF considers that the likely incidence of Administered Price Periods (APP) due to Market Ancillary Service (MAS) prices is so low that there will be little effect on longer term market incentives. Hence, we do not consider that questions related to long-term incentives should be afforded any weight.

The main consideration in reviewing the detailed arrangements should be the risk of violations of system security and the consequent need for AEMO to use or potentially over-use its power of direction. The circumstances leading to an APP are likely to be complex and demanding for AEMO as system operator and hence in the APP arrangements any increase in the need to use AEMO's power of direction should be avoided.

The risk to system security may arise if an APP leads to market incentives for generators to withdraw offers of market ancillary services.

Under normal market conditions, generators are not disadvantaged if their energy dispatch is reduced in order to dispatch market ancillary services. This is because the pricing of MAS includes not only the offer price of the service dispatched, but also the reflected costs from the energy market dispatch of providing the service. Hence, MAS revenue will normally compensate for any reduction in energy dispatch.

However, if MAS prices are capped during an APP, there is a risk that generators will be disadvantaged by the dispatch of MAS that they have offered. In this case the generators will be faced with an incentive to withdraw their offers of MAS provision in order to maximise their total market revenue. If sufficient generators act in accordance with this market incentive, then system security are likely to be compromised.

Our first conclusion from this is that an APP triggered by raised service prices should not cap lower service prices and vice versa. But we do not support a more restrictive application than this. We suggest that, for example, high price for one contingency raise service are likely to be associated with high prices in other contingency raise services, and hence there would be little benefit in the additional complexity of confining the capping to the specific service for which the prices first reach the trigger.

Our second conclusion from this is that there should be a close alignment between rules for an APP from energy prices and one from MAS prices. We note in this context that the process in the energy market of universal trading interval settlement is known to cause market distortions especially in the case of peak-load generators, but also potentially in the case of scheduled loads. We therefore contend that it would be unwise in this context to assume that trading interval settlement of energy will continue for all participants. The dispatch interval, being the fundamental time unit of the market, would be a more secure basis for the Rules relating to APPs.

With regards to the proposal to amend clause 3.14.2(c)(3) - the discretionary provision which enables the Australian Energy Market Operator (AEMO), in consultation with the Australian Energy Regulator (AER), to extend an APP into the next trading day - the NGF supports the proposed option 3(b). Option 3(b) advocates retaining clause 3.14.2(c)(3) of the Rules in an amended form where the decision to extend the APP is based on data in the pre-dispatch schedule. The NGF considers it important to retain an option to extend the APP, which assists market participants to manage risks incurred during prolonged extreme market price events. Moreover, replacing AEMO's discretion to extend the APP with an objective test gives participants greater certainty and allows them to more effectively manage their exposure to the market.

The NGF appreciates that imposing an objective test may increase the risk that generators 'game the system' by bidding with the intent to influence the decision as to whether an APP is extended. However we note that if an APP has been triggered and has had a material effect on prices then the accumulation of uncapped prices is likely to finish the day significantly above the trigger level in any event. It is therefore likely that the APP will be in place without recourse to clause 3.14.2(c)(3). This likelihood diminishes the power of participants to game the test.

While the Commission is considering matters in relation to APPs, we believe that it should correct a logical error in clause 3.14.2(e)(4), which should read –

(4) at any regional reference node is set to the administered floor price under clause 3.14.2, then dispatch prices at all other regional reference nodes connected by a regulated interconnector or regulated interconnectors that have an energy flowaway from that regional reference node must be equal to or greater than the product of the administered floor price multiplied by the average loss factor for that dispatch interval between that regional reference node and the regional reference node at which dispatch prices have been set to the administered floor price determined in accordance with clause 3.14.2(e)(5).

The (rare) circumstances in which this provision is meant to have its effect are as follows –

- The prices in two connected regions are both negative and one region's price becomes subject to the administered price floor,
- There is a dispatched flow between the regions which is economic (and hence leads to a settlement residue) on the basis of the original dispatch prices, but leads to a settlement deficit when the floor price is applied

The intended effect of this provision is to eliminate this settlement deficit by an adjustment to the price in the region that was not initially subject to the price floor. In this it is similar to 3.14.2(e)(2) in its effect, but in relation to a price floor rather than a price cap.

These circumstances can arise only in the case where the dispatched flow is away from the region where the price floor is applied, not in the case of flow toward the floored region as implied by the current Rule. The application of a price floor raises the price and hence threatens the economics of flows away from that region, but would improve the economics of any flow toward the floored region.

If you have any questions in relation to this submission please call Ken Secomb on 03 9617 8321 or David Hoch on 03 5135 5363.

Yours sincerely



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