

18 January 2008

Dr John Tamblyn  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
SOUTH SYDNEY NSW 1235

By email: [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au)

Dear Dr Tamblyn,

### Review of the Schedule of the Administered Price Cap

The Energy Retailers Association of Australia (the Association) welcomes the opportunity to provide comments on the review of the schedule of the Administered Price Cap (APC).

#### *Policy Objective of the APC*

The Association believes the setting of the Cumulative Price Threshold (CPT) and the APC are important components of the National Electricity Market (NEM) safety net, which operates when triggered to limit market participants' exposure to the wholesale spot market during periods of prolonged high prices. As the NEM is quite volatile such sustained high prices can result from both normal<sup>1</sup> and abnormal<sup>2</sup> market conditions, and without these provisions the market would experience substantial financial stress (and potentially systematic financial collapse).

The Association believes the APC should not be seen or used as a mechanism for allowing generators to obtain opportunistic return on their capital investments. Rather, it is intended that the period prior to the CPT being triggered is the period when investment returns should be earned. The policy objective of the APC should be to limit the financial stress on the market during extreme conditions (or market failure).

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<sup>1</sup> For example extreme weather conditions, which leads to extreme demand across the NEM.

<sup>2</sup> For example major industrial disputes, natural disasters or systemic market failure.

While the object of the APC is to limit overall financial stress in the market, this needs to balance against the need to ensure the APC is sufficient to encourage available generator or demand side resources to continue to participate in the market. The ability of retailers to manage financial exposures even following the imposition of the APC is also important - as outlined in the following section.

#### *Ability to Seek Compensation*

An important component of the APC is the ability for generators who are dispatched in offer bands that are priced higher than the APC to claim compensation from the National Electricity Market Management Company (NEMMCO) under clause 3.14.6 of the National Electricity Rules (**Rules**). The Association has in the past expressed concern to the Australian Energy Market Commission (AEMC) regarding the operation of the current compensation provisions following an administered price period (**APP**); in particular the substantial compensation retailers could be required to pay generators if the bid prices were to be the basis for compensation and the inability to hedge such unknown risks.

The Association believes EnergyAustralia's Rule change proposal, dated 10 December 2007 will address a number of the Association's concerns by removing much of the uncertainty over the criteria for determining compensation, by making it clear that the objective of the compensation provisions are to ensure that a dispatched generator is only able to recover its direct generating costs during periods of capped spot prices. It also better delineates between the tasks of a) deciding on whether compensation should be awarded, and b) determining the compensation amount.

While ensuring inappropriate returns through compensation are limited is important, this change in itself is not sufficient to ensure that unhedgeable compensation payments do not arise for retailers.

In addition, it is important to consider the incentives available to demand side and high fuel cost generators to continue operating following the imposition of an APC. Setting the APC too low could lead to insufficient incentive for them to produce during capped

periods if they are forced to weigh the high but certain costs of producing, against the uncertainty of collection associated with compensation claims.

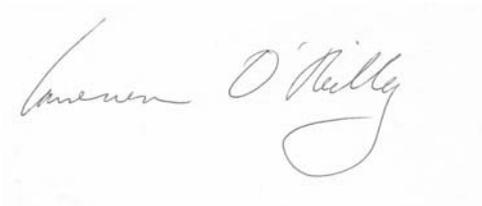
Getting the balance right between these conflicting drivers is the key challenge faced by the AEMC in determining an appropriate APC.

*Level of the Administered Price Cap*

The Association is unable to form a collective position on what the appropriate level of the APC should be, with some members suggesting no change, while others believe a flat \$500/MWh (subject to an annual adjustment for CPI) is appropriate. Individual members will provide details of their reasoning behind their positions in separate submissions to the AEMC.

Should you require any further information in relation to this matter please feel free to contact me on (02) 9437 6180.

Yours sincerely



Cameron O'Reilly  
Executive Director  
Energy Retailers Association of Australia