AUSTRALIAN ENERGY REGULATOR

GPO Box 520
Melbourne VIC 3001
Telephone: (03) 9290 1444
Facsimile: (03) 9663 3699
www.aer.gov.au

Our Ref: 41173
Contact Officer: Stephen Dillon
Contact Phone: (03) 9290 1447

30 April 2010

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

Dear Dr ~~Tamblyn~~ John

Request for Rule Change - Timeframe for reporting on spot prices above $5000/MWh events

I am writing seeking an expedited Rule change in accordance with the provisions related to non-controversial rule changes under section 96 of the National Electricity Law.

Specifically, I am writing to propose an amendment to clause 3.13.7 (d) of the National Electricity Rules which requires the AER to publish a report when the spot price exceeds $5000/MWh, within 20 business days of the end of a week in which the event occurred.

The requirement to report on circumstances where the spot price exceeds $5000/MWh was introduced in January 2001 in response to the increase in the market price cap from $5000/MWh to $10 000/MWh. In its final report into the increase in the price cap, the Australian Competition and Consumer Commission (ACCC) noted its concerns about how market power might manifest itself with a higher price cap, and in particular the ability of generators to game the market and force up prices. Consequently, the ACCC extended the monitoring functions of the then National Electricity Code Administrator (NECA), requiring it to report on the circumstances where the spot price exceeds $5000/MWh.

The AER devotes considerable resources to meeting its obligations under clause 3.13.7(d). Reporting on extreme price events enhances market transparency by highlighting major disturbances and identifying underlying causes. In particular, the reports help to distinguish between price outcomes that reflect competitive forces and the proper functioning of the market, and those attributable to inefficiencies in market design or potential non-compliance with the Rules by market participants.

The value of these reports inevitably depends on the quality of analysis they contain. Recent experience suggests that the 20 business days timeframe has the potential to significantly constrain quality in this regard. While this timeframe may have been reasonable when the Rule was first introduced in January 2001, developments in the market since then have made it increasingly impractical to meet.

In particular, the number of $5000/MWh events has steadily increased over the past decade, from 8 events in 2001–02 to 68 events in 2008–09. At the end of March 2010, there had been 87 events in the year to 30 June 2010. Even though several related events are sometimes covered in a single report, the increase in the number of events has made it difficult to meet the deadline.

Since the provision first became effective in January 2001, a number of developments has meant that the analysis of spot prices above $5000/MWh has become more complex and time consuming. These developments include:

- The introduction of the frequency control ancillary services (FCAS) markets;
- Increased network congestion, in part due to the use of fully co-optimised constraints;
- Increased volatility in spot market outcomes, in part due to recent climate change policies and the resultant increase in the penetration of wind generation;
- The introduction of the good faith rebidding provision;
- Increasing sophistication in participant bidding strategies; and
- The continuing convergence between activities in the electricity and gas markets.

As a result of these added complexities, the AER is often required to seek further information from AEMO and registered participants before any conclusions can be reached and the report published. This can take some time and can lead to delays in publishing the reports.

These events also tend to have a strong seasonal element and, although there have been a number of events in the winter months, are generally concentrated around the summer months—placing heavy demands on AER resources.

While the AER aims to meet the timeframe, it has become increasingly difficult to do so. The AER is concerned that the retention of the current timeframe may pose a risk of compromising the quality of future reporting.

The AER proposes that these problems can be resolved by extending the reporting timeframe to '…**within 40 business days**…'. In the environment where the number of and complexity of events is increasing, this would allow for more detailed analysis and more considered reporting to better inform participants of market conditions. In doing so, the reports can provide more useful input for investment decisions and better inform policymakers on structural issues in the market.

The attachment sets out further details of this proposal. If you have any questions please do not hesitate to contact Stephen Dillon on (03) 9290 1447 or me on (03) 9290 1421.

Yours sincerely

Steve Edwell
Chairman

National Electricity Rules

Proposal to change clause 3.13.7 (d)

A Name and address of person making the request

Australian Energy Regulator
Level 38
360 Elizabeth St
MELBOURNE VIC 3000

B Description of proposed rule

The proposal relates to clause 3.13.7 (d) of the National Electricity Rules, which currently requires that:

> *The AER must, **within 20 business days** of the end of a week in which the spot price exceeded $5,000/MWh in a trading interval or trading intervals, prepare and publish a report which must for each trading interval in which the spot price exceeded $5,000/MWh in that week:*
>
> *(1) describe the significant factors that contributed to the spot price exceeding $5,000/MWh, including the withdrawal of generation capacity and network availability;*
>
> *(2) assess whether rebidding pursuant to clause 3.8.22 contributed to the spot price exceeding $5,000/MWh; and*
>
> *(3) identify the marginal scheduled generating units and semi-scheduled generating units for the dispatch intervals in the relevant trading interval and all scheduled generating units and semi-scheduled generating units for which any dispatch offer for the trading interval was equal to or greater than $5,000/MWh and compare these dispatch offers to relevant dispatch offers in previous trading intervals.*

The AER proposes that the bolded words (within 20 business days) be changed to '**within 40 business days.**'

C Statement of Issues

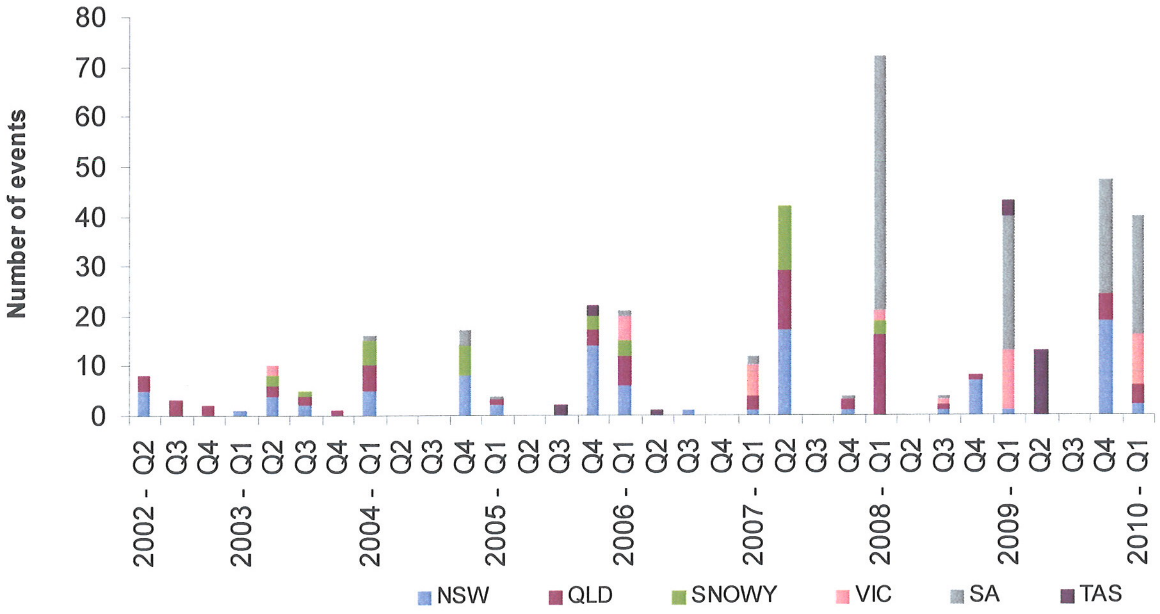
Reporting on spot price events above $5000 a megawatt hour can enhance transparency by highlighting market disturbances and identifying underlying causes. In particular, the reports help to distinguish between price outcomes that reflect competitive forces and the proper functioning of the market, and those attributable to inefficiencies in market design or potential non-compliance with the Rules by market participants.

The value of the reports inevitably depends on the quality of analysis they contain. Recent experience suggests that the 20 business day timeframe may significantly constrain quality in this regard. While this timeframe may have been reasonable when the Rule was first introduced in January 2001, developments in the market since then have made it increasingly impractical to meet.

In particular, the number of spot prices above $5000/MWh events has steadily increased over the past decade from 8 events in 2001–02 to 68 events in 2008–09. At the end of March 2010 there had been 87 events in the year to 30 June 2010 (figure 1). This already exceeds the previous record number of events set in 2007–08.

Even though several related events are sometimes covered in a single report, the increase in the number of events has made it difficult to meet the deadline.

Figure 1 Trading Intervals above $5000 a megawatt hour (quarterly)—National Electricity Market



Since the provision first became effective in January 2001, a number of developments has meant that the analysis of spot prices above $5000/MWh has become more complex and time consuming. These developments include:

- The introduction of the frequency control ancillary services (FCAS) markets (complex interactions between FCAS and energy can lead to high spot price outcomes);
- Increased network congestion, in part due to the use of fully co-optimised constraints. This has been particularly relevant during the recent summer events in New South Wales;
- Increased volatility in spot market outcomes, in part due to recent climate change policies and the resultant increase in the penetration of wind generation;
- The introduction of the good faith rebidding provision. Analysis of rebids to ensure compliance with the good faith provision may involve seeking further information from participants, further delaying publication. These reports may form the basis of further investigations;
- Increasing sophistication in participant bidding strategies; and
- The continuing convergence between activities in the electricity and gas markets, especially with the increase in gas-fired generation and consequent arbitrage opportunities between the two markets. The AER has monitoring and reporting roles in both sectors.

As a result of these added complexities, the AER is often required to seek further information from AEMO and registered participants before any conclusions can be reached and the report published. This can take some time and can lead to delays in publishing the reports.

These events also tend to have a strong seasonal element and, although there have been a number of events in the winter months (for example in Tasmania in June of last year), are generally concentrated around the summer months—placing heavy demands on AER resources. While the AER aims to meet the 20 business day timeframe, given the increase in the number of events (as shown in figure 1) it has become increasingly difficult to do so.

The AER is concerned that the retention of the current timeframe may pose a risk of compromising the quality of future reporting.

The AER proposes that these issues can be addressed by extending the reporting timeframe to **'...within 40 business days...'.** This would allow for more detailed analysis and more considered reporting to better inform participants of market conditions. In doing so, the reports can provide more useful input for investment decisions and better inform policymakers on structural issues in the market.

D How the proposal contributes to National Electricity Objective

The national electricity objective (the objective) is stated in section 7 of the National Electricity Law as being:

> *to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –*
>
> *(a) price, quality, safety, reliability and security of supply of electricity;*
>
> *(b) the reliability, safety and security of the national electricity system.*

The AER considers that the proposed rule change would contribute to meeting the objective by facilitating more considered analysis of the causes of extreme prices. The rule change would thereby assist market participants and policymakers in making appropriate responses. In particular, the enhanced analysis would more clearly delineate between price outcomes that reflect competitive forces and the proper functioning of the market (which may warrant an investment response) and those resulting from inefficiencies in market design or potential non-compliance with the Rules by market participants (which may warrant a policy or regulatory response). In encouraging efficient investment and energy policy, the rule change would promote efficient market outcomes, including a more reliable, safe and secure power system.

E Costs and benefits and potential impacts on those affected

The benefits of this proposal are outlined above. In summary, better quality reporting is likely to assist energy customers by enhancing market transparency and promoting efficient infrastructure investment.

The cost of the change is that some reporting on high price events may occur up to 20 business days later than under current arrangements. However, the AER considers that in the context of a market with long investment and policy making lead times this delay is unlikely to be material, and would be more than offset by the benefits of better quality reporting.