



What is the right MPC and CPT?

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Reliability Settings

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Overview

- Perspectives differ within the NGF as to whether an increase in the MPC is warranted
- The NGF supports an appropriate balance being struck between the need to encourage new investment while, at the same time, not introducing excessive market risk
- There appears to be a conflict between ROAM's conclusions and the AEMO ESOO which sees reliability being met for many years under the existing MPC
- The analysis is very supply side focussed whereas much investment is made by vertically integrated businesses managing their risks based on demand side considerations
- While the NGF has not examined ROAM modelling assumptions in detail, it notes that spot revenues required to recover costs of peaking generator are highly sensitive to capital costs and bidding assumptions. It also ignores contracts... but it is contracts that drive new investment, not spot market revenues
- The NGF also notes the importance of the CPT in managing risk in the market while ensuring peaking generators can recover costs. But its relationship with MPC is little examined in ROAM modelling
- Insufficient attention to these issues may lead to setting the CPT too high. This will increase market risk with little additional benefit to reliability outcomes

Reliability Standard

- NGF supports the retention of the current settings
 - Unserved Energy form
 - Level at 0.002%
 - Retain current scope for “acts of God”
 - Retain operational approach
- NGF opposes changing USE standard to make the system less reliable
 - Given political reactions to any shortages

Divided view on whether an increase in the MPC is required

- Some members support an increase in the MPC because they agree:
 - ✓ Generator costs have increased by 22% in real terms in the past two years
 - ✓ MPC is a nominal value whose real value decreases over time
 - ✓ Demand will be peakier in the NEM over the next 10 years which will reduce the number of hours an OCGT can run to recover its costs;
- Other members do not support an increase in the MPC because:
 - ✓ The market is currently delivering the reliability standard at \$10,000/\$12,500 per M/Wh
 - ✓ Generators face an increase in market risk due to transmission congestion
 - ✓ Generators face an increase in their generation risk due to an increase in the MPC
 - ✓ Demand drives investment to a much greater extent than MPC

Existing market signals appear to be working

- NGF acknowledges the important role of the MPC in ensuring reliability. But committed and announced projects in the AEMO SOO suggests expected reliability out to 2019 is sound under existing market signals
- ROAM focuses on spot market revenues needed for a super peaking plant. But no peaking plant will enter market on the basis of spot revenues... cap contracts and the contract market more broadly are what matter
- Existing market volatility drives retailer demand for cap contracts, who have strong incentives to ensure risks are managed conservatively (demand for contracts tends to lift contract prices ahead of what underlying supply-demand fundamentals would suggest)
- Contract prices are determined by complex array of factors (supply, demand, market structure, policy-regulatory settings, appetite for risk) of which the level of the MPC is but one factor
- For these reasons contract prices tend to trade at a premium to expected spot prices

Modelling outcomes sensitive to assumptions

- Determining the level of the MPC on the basis of modelling alone is problematic given its sensitivity to input assumptions.
- In similar modelling performed for the Comprehensive Reliability Review, CRA noted how even small variations in outage rates, generator availability, fuel and capital costs, transmission constraints, significantly changed the prospects for OCGT cost recovery under a given MPC
- They also noted how generator bidding assumptions strongly influence modelling outcomes- highlights the impossibility for modelling to capture all the variables that influence bidding decisions.
- In particular, it is highly unlikely that ROAM's assumption that future bidding will reflect historical bidding will hold under a complete change in policy environment going forward
- Assumption by ROAM that CPT does not intervene in MPC events is unrealistic

Little consideration of CPT

- The ROAM report focuses on the level of the MPC.... but CPT just as important
- ROAM notes that changing shape of future demand duration curve means less peaks available for OCGT to recover costs.. thus higher MPC required.
- However it should follow then, with a higher MPC, that OCGT will recover costs more quickly and therefore CPT accumulation period should arguably be shorter.. and not longer as ROAM recommends
- More work needs to be done to identify the appropriate relationship between the MPC and CPT
- Perhaps examining CPT being set by having regard to market failure, ie duration of MPC for CPT based on notion of prudential impacts on market as a whole

Issues associated with raising MPC

- A higher MPC increases generator exposure to outage risk, which may therefore lower the level of contracts generators wish to carry
- Higher MPC, with associated higher CPT, increases potential pay-offs from strategic bidding, reinforcing incentives for generation to contract less.
- Both factors may increase price volatility
- **BUT** this could increase retailers contracting requirements and create product innovation in the financial market
- Higher price volatility will increase risks in the market, to both contracted generators and retailers, may disproportionately affect smaller independent retailers and merchant plant who will be less able to secure financing and manage high prudential costs
- An excessive MPC may therefore reduce market competition with higher costs passed through to consumers.

Market Price Floor

- No current consideration of level of Market Price Floor (-\$1000)
- Needs consideration as any price below negative REC price will clear the market
- A less negative value may be less disruptive during bidding around constraints
- NGF requests some analysis of merits of change

Summary

- Broad support for reliability settings
- Differing generation views on required level of MPC to meet reliability standard
- Need for serious reconciliation of ROAM results with CRR and ESOO analysis
- Need a broad based assessment not entirely based on supply side modelling
- Need more work on best level of CPT
- Need for analysis of merits for a change to MPF