28 August 2023

Ms Anna Collyer
Chair
Australian Energy Market Commission
Level 15, 60 Castlereagh Street
SYDNEY NSW 2000

By electronic submission

Dear Ms Collyer,

Rule change request - CPT calculation during administered scheduled pricing

Snowy Hydro submits the attached request for the Australian Energy Market Commission (AEMC) to amend the National Electricity Rules (NER).

The Cumulative Price Threshold (CPT) and Administered Price Cap (APC) are key design features of the NEM. The logic of the CPT suggests that when breached, the protection offered by the administered price cap should remain in place until the market conditions that caused the extreme spot prices subside. Currently, however, when a market suspension event occurs, market event scheduled pricing serves as an input into the calculation of the CPT. If the market suspension is in place for long enough, this can effectively cause the premature ending of APC protection for market participants. This is inconsistent with, and undermines the purpose of the CPT and APC. Accordingly, Snowy Hydro proposes this rule to address this anomaly.

Feel free to contact me if you have any questions about this submission should be addressed to panos.priftakis@snowyhydro.com.au.

Yours sincerely,

Panos Priftakis
Head of Wholesale Regulation
Snowy Hydro

Background

The NEM's reliability settings are assessed by the Reliability Panel, which seeks to optimise the settings to deliver strong and robust investment signals to meet the Reliability Standard at least-cost to consumers. The current Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Cap (APC) form a natural hedge for sellers of risk management derivatives.[1]

As part of these settings, the CPT has three purposes which is to:

- cap the total price risk to which market participants and customers are exposed over a given time period;
- protect all market participants from prolonged periods of high market prices, with particular consideration to impacts on investment costs and the promotion of market stability; and
- not impede the ability of the market to determine price signals for efficient operation and investment in energy services, and be determined by giving consideration to the level of the MPC.

The APC, combined with the CPT, is a mechanism designed to minimise financial instability risks to the market arising from an extended period of supply scarcity and correspondingly high prices.

The transition to greater variable renewable energy (VRE) and storage will impact the effectiveness of the CPT and APC. The Reliability Panel[2] recently examined whether the current form and level of the CPT sends the right price signals to invest in an appropriate mix of short, medium and long-duration energy storage projects; however an important consideration should also be the calculation of the CPT following a market suspension.

Overview of the recent APP event In the APP that occurred between 12 - 14 June 2022

The CPT is currently set at a level equal to 7.5 hours of pricing at the Market Price Cap (MPC), and, when breached, triggers the application of administered pricing. The incidence of volatility in the NEM will grow given increasing penetration of VRE, but other factors are relevant. The Reliability Panel observed that extreme events in the NEM can be coincident with abnormally high fuel, especially gas, prices. In 2022, the cost of gas, coal, and liquid fuel prices increased significantly as a result of geopolitical conflict and local fuel shortages. Reduced available capacity drove higher wholesale costs due to higher demand during winter, lower than average wind and solar output, and a large volume of planned and unplanned outages from thermal generators.

Challenging market conditions resulted in the exceedance of the CPT in QLD on 12 June 2022, and NSW, SA and VIC on 13 June 2022 when the APC was applied in these NEM regions[3]. On 15 June 2022, AEMO suspended the market, citing difficulties associated with managing a large number of constraints and supply limitations, which created issues for AEMO's automated systems and processes. In accordance with clause 3.14.5(b), prices

[1] Reliability Panel, 2022 Review of the reliability standard and settings, Final report, 1 September 2022.
[2] Ibid.
[3] Ibid.

were set in accordance with the market suspension pricing schedule, or scheduled pricing. This pricing is based on the 28 day historical average for the relevant region and is capped at the APC.

An anomaly became apparent during this event whereby if the market suspension is in place long enough, it results in the cumulative spot prices being below, or well below, the CPT when the scheduled pricing is removed. This can occur despite the market conditions that initially caused the breach of the CPT persisting. This can lead to the immediate resumption of extreme spot prices, undermining the protection that the CPT was designed to provide.

Rationale

In Snowy Hydro's view, the intent of the Cumulative Price Threshold (CPT) and subsequent Administered Pricing Period (APP) which imposes an Administered Price Cap (APC), is to provide protection to "short" market participants, while balancing the need to provide revenue adequacy for generators. A "short" market participant is one that has insufficient bought energy (via bought electricity contracts and/or owned generation) to cover their sold energy position (retail load and/ or sold electricity contracts).

The protection that the APC provides "short" market participants is against prolonged and extremely high spot prices. While in theory short market participants will be retailers or large market customers, it is also very likely to include scheduled generators that have sold electricity contracts (probably caps) to retailers. The key point is that the protection afforded by the APC should not be diminished because of a decision to suspend the market. However, that is what currently occurs given that scheduled pricing is used as an input into the CPT calculation.

Snowy Hydro's solution is that the CPT calculation should be suspended for periods during which administered scheduled pricing has been introduced, and continued when scheduled pricing is removed.

Expected Benefits and Costs and Potential Impacts on Those Likely to be Affected

The expected benefits of this rule change request include:

- it will remove the distortion to the CPT/APC caused by the use of scheduled pricing and thereby improve the integrity of the CPT/APC. Given that scheduled pricing does not reflect real world scarcity of supply during periods of volatility, its use artificially hastens the protection that the APT/APC is designed to provide to market participants;

- as a consequence of addressing this issue, the CPT/APC will be better able to achieve its objective of providing a safety valve during periods of extended volatility and, in particular, reducing tail risk for sellers of hedges. If not addressed, sellers of hedges will be exposed to a higher tail risk, increasing the risk premium and the cost of energy; and

- market participants, both generators and market customers, will have increased financial protection against periods of extended volatility, as the CPT/APC will not be artificially shortened by the use of scheduled pricing. This will improve certainty of the protection offered by the CPT/APC, allowing participants to plan their operations and contacting activity with greater confidence.

The only potential cost associated with this proposal would be experienced by those who would otherwise benefit from a shorter APC period occasioned by the use of scheduled pricing (for example, generators which are not fuel-constrained who are able to take advantage of pricing volatility when the APC ends). However, given the near impossibility of accurately forecasting the likelihood of scheduled pricing, this can only be considered an opportunistic benefit, ie. it is unlikely that such generators are able to plan their operations around this benefit or to assume a benefit from it *ex ante*.

The impact of this proposed rule on those likely to be affected by it is greater confidence in the protection offered by the APC/CPT and increased protection against periods of extended volatility in the NEM. This will reduce the risk of financial insolvency for market participants. It should also enhance the ability of AEMO to operate the NEM, as it will promote a more stable market.

Given this change is straightforward it should not have any system or implementation costs.

How the Proposal will Contribute to the National Electricity Objective

This proposed rule will contribute to the National Energy Objective as follows:

- by improving the integrity of the CPT/APC and increasing the predictability of the market during extreme volatility:
  - it will promote a more efficient and stable operation of the NEM; and
  - it will improve investment certainty in electricity generation assets;
  - therefore delivering a more safe, secure and reliable power system; and;
  - thus improving outcomes for customers.
- market participants will be less exposed to financial insolvency, which will improve reliability of supply; and
- it will reduce the risk premium for sellers of hedges, which would otherwise be required to manage the risk of a sudden loss of APC/CPT. This will put downward pressure on the cost of electricity.

Changes to be made in the NER

Amend clause 3.14.2 as follows.

3.14.2 Application of Administered Price Cap

(a) [Deleted]

(b) AEMO must immediately notify all Market Participants of the commencement and closing of an administered price period under rule 3.14.

(c) Each of the following periods is an administered price period in a region:

(1) a trading interval, where the sum of the spot prices in the previous 2,016 trading intervals, calculated as if this clause did not apply and excluding any *trading interval* in respect of which the spot price is set by AEMO in accordance with the *market suspension pricing schedule*, exceeds the cumulative price threshold;

(1A) a trading interval, where the sum of the ancillary service prices for a market ancillary service in the previous 2,016 trading intervals, calculated as if this clause did not apply and excluding any *trading interval* in respect of which the ancillary service price is set by AEMO in accordance with the *market suspension pricing schedule*, exceeds the cumulative price threshold; or

(2) a trading interval in a trading day in which a prior trading interval is an administered price period.

(2A) [Deleted]

(2B) [Deleted]

(3) [Deleted]