12 October 2022

Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Electronic submission

Dear Sirs,

National Electricity Amendment (Amending the Administered Price Cap) Rule

Snowy Hydro welcomes the opportunity to comment on the matters raised in the Directions paper from the Australian Energy Market Commission on the National Electricity Amendment (Amending the Administered Price Cap) Rule ("Rule Change Request").

Snowy Hydro expresses its utmost concern regarding the Commission's proposal to immediately increase the Administered Price Cap (APC) to $600/MWh. As mentioned in our previous submission, Snowy Hydro supports an increase in the APC, however we consider that an increase should not take effect until Q1, 2025, when most existing cap contracts have expired. Snowy Hydro is disappointed that the Commission has rejected this approach and has not adequately considered the impacts on the contracts market.

The Commission States "The overall impact on contract prices from a higher APC is expected to be minimal.", arguing that if the events of June 2022 were to recur under a revised APC of $600/MWh, the additional cap payout would increase by less than $1/MWh on average across the NEM. This analysis is flawed because it uses market-wide averages to conceal the impact of a change which will expose a systemically-important subset of participants (ie. fuel-constrained generators) to potentially catastrophic financial loss. If, as appears to be the case, the Commission considers this to be an acceptable trade-off in order to obtain the benefits of an immediate increase to the APC, it should acknowledge this openly and transparently, and explain why.

To reiterate the fundamental point made in our previous submission, an increase in the APC implies an increase in the volume of generation, and therefore fuel, required to defend a cap contract. Given that hydro generators cannot increase fuel reserves (water), increasing the APC while existing cap contracts remain on-foot will impose direct financial costs on generators. Snowy Hydro estimates that were the events of June 2022 to recur under a revised APC of $600/MWh and before existing $300 caps have expired, the cost to Snowy Hydro could exceed $100m.

The Commission further suggests:

> *The origins of the $300/MWh price in the cap contracts commonly traded in the NEM are not related to the APC. The $300/MWh price originally came from the VicPool electricity market's coinsurance scheme which dates back to 1994 …..As such, changing the APC does not require cap contracts be struck at the new level of the APC…*

The Commission appears to be arguing that because in 1994 the strike price of $300 caps was determined independently of the level of the APC, there is no reason why the APC cannot now be increased in a way which causes misalignment with strike price of existing cap contracts in 2022. The historical formulation of $300 caps is, in fact, irrelevant to the proposed change and its citing by the commission is dangerously misleading.

We can only repeat the point made in our previous submission. Snowy Hydro confirms that the level of the APC is a critical input into its contracting strategies. If the APC had been different at the time at which existing $300 caps were sold, or if there was a reasonable prospect that the APC would be increased on an expedited basis, as contemplated in the Rule Change Request, Snowy Hydro would have contracted differently. Again, this has been ignored in the Directions Paper. The Commission effectively suggests that the historical basis for the setting of the strike price in $300 caps in 1994 is more important for the purposes of the current rule change than its role as an input into the contracting decisions of fuel-constrained generators. It should hardly need saying that Snowy Hydro understands the commercial inputs into its own hedging and risk strategies better than anyone else.

We urge the Commission to properly consider the impact of the rule change on participants in the contacts market, and accordingly delay the increase in the APC to Q1, 2025. Failure to do so will expose fuel-constrained generators to severe financial loss. It will also cause a loss of liquidity, both through its impact on existing contracts and by establishing a precedent - abrupt changes in market price settings - which will deter contracting in future periods. In failing to take these matters into account, the Commission's proposed decision fails the National Energy Objective. Liquidity in secondary markets is always essential to the efficient operation of the primary market. In damaging the contracts market, this decision would, therefore, damage the health of the NEM.

If the Commission nevertheless decides to recommend an immediate increase in the APC, it should make two further changes. Firstly, in order to mitigate losses for fuel-constrained generators, the APC should be increased to $500/MWh rather than $600/MWh. Given current gas pricing, this will avoid uneconomic dispatch during administered pricing, and it would align with the trend toward $500 strike caps in the contract market.[1] Secondly, as part of its decision, it should implement corresponding arrangements to compensate affected sellers of caps for any loss they incur as a consequence of an immediate increase in the APC under existing cap contracts. Such change would, however, only be effective to the extent that it is implemented contemporaneously with the increase in the APC itself (and not simply identified as an option for consideration in the future)

Yours sincerely,

Leigh Creswell

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Snowy Hydro Limited

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[1] For example, the listing of $500/MWh strike caps on the FEX exchange.