INFORMATION

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Amending the administered price cap

AEMC makes final rule on amending the administered price cap rule change

The Commission has decided to make a final rule on amending the administered price cap (APC) to mitigate ongoing threats to the reliable operation of the NEM (National Electricity Market).

The Australian Energy Market Commission (AEMC) and other regulatory agencies have been reviewing market settings since the Australian Energy Market Operator (AEMO) was forced to suspend the wholesale electricity market in June, following an extended period of unprecedented volatility and extreme prices.

The change to the APC follows a rule change by Alinta Energy which seeks to ensure that prices during an administered price period (APP) are sufficient to cover the costs of most generators operating under today's market conditions to support normal market operation and settlement.

The AEMC is taking action to implement rules to manage the risk of major supply shortfalls in the future as the energy market transitions and to avoid the potential for costly and damaging blackouts for households and businesses.

The final rule is transitional and changes the APC from $300/MWh to $600/MWh, to be implemented on 1 December 2022 and remain in place until 30 June 2025. Any change to the setting longer-term would be made following the AEMC's consideration of the Reliability Panel's rule change request.

Raising the APC to this level will enable more generators to supply additional electricity when it is needed most.

Importantly, the APC only caps prices during rare emergency situations. It has no impact on wholesale prices during the normal market conditions that operate most of the time.

No temporary change to the cumulative price threshold (CPT) is being made as part of this final rule.

Purpose of the APC

The Administered Price Cap is a tool to stabilise the market through periods of significant and extended volatility by capping spot prices paid by market participants when volatile or high prices reach a cumulative price threshold defined by the rules. The APC should reduce risk and financial distress to market participants by limiting their spot exposure, and at the same time, it should provide sufficient spot revenues for generators to cover their short-term costs and incentivise them to supply energy while the APC is in operation.

The APC can be thought of as a last-resort safety net that stabilises the electricity system by capping prices in the National Electricity Market during rare emergency situations, following a prolonged period of extreme prices. The APC has only been used three times in the 24 years since the National Electricity Market commenced.

In 2022, due to international events and local fuel constraints, market fuel prices for peaking generators in the NEM have risen to unprecedented levels. This has caused some gas and liquid-fuelled generation to be more expensive to operate than the price allowed for under the existing level of the APC.

In June, major reliability risks were averted when the Australian Energy Market Operator, facing what it described as an "impossible situation", issued nearly 500 emergency directions for offline generators to start generating power – but this approach is not sustainable over prolonged periods.

To protect customers from these situations in future, the AEMC has decided to make a prudent change to the market settings to increase the Administered Price Cap (APC) in order to secure our electricity supply and keep the system stable as we transition to more renewable energy.

Benefits of the final rule

The final rule, in providing for a transitional rule that increases the level of the APC from $300 to $600/MWh on 1 December 2022, is in the long-term interests of consumers. The rule promotes power system safety, security and reliability, by encouraging generators to operate through normal market dispatch during administered price periods (APP). This will facilitate optimal market dispatch and reduce the potential for constraints that may limit AEMO's ability to effectively operate the wholesale market and manage security and reliability. This should enable the power system to operate in a secure operating state with consumers at less risk of being exposed to load shedding.

The final rule should reduce costs for consumers by lowering the cost of dispatch in the NEM and minimising compensation costs that would otherwise need to be paid by consumers. A higher APC during the APP should facilitate normal market dispatch by ensuring that the price cap is sufficient to cover the variable operating costs of most generators and enable greater amounts of hydro and battery storage to charge and discharge.

Impacts on the value of contract market instruments and the operation of contracts already in effect in the market, are expected to be minimal. Analysis of June's events published in the final determination indicates prices would be unlikely to trend up to the new level of APC were such events to recur, and are likely to be reduced by the impact of an additional 3,500-5,900 MW of generation now able to bid into the market during APP and recover its costs.

Background on the APC, APP and CPT

The market operator AEMO, calculates the rolling seven-day cumulative market price in each region. When that cumulative price reaches a predefined level, known as the cumulative price threshold (CPT), in any region the administered price period (APP) starts and market prices in that region are capped by the APC. Prices remain capped during the APP until the cumulative price falls back below the CPT. The APC, currently $300/MWh, is the maximum market price paid to market participants in any dispatch interval, during an APP. While limiting a market participant's spot exposure during the APP, the APC should provide sufficient spot revenue for generators to cover their variable costs and support a return to normal market operation as soon as possible. The APC and CPT work together to limit market participant financial exposure, maintain pricing signals for new developments and support the achievement of reliability standards. The CPT is indexed to movements in CPI. The Reliability Panel recommends the values that manage reliability, including the APC and CPT, and are set by AEMC's normal rule change process.

At the start of the NEM, systemic financial collapse as a result of a generator failure causing sustained high spot prices was a major concern. Then, as now, when a generator fails, it can face significant financial exposure against its hedging contracts. High spot prices may drive contract payments from the generator, for periods where it was unable to generate and earn spot revenue. Similarly, retailers with insufficient hedge contract cover may face purchasing some portion of their customer load from the market at prices significantly higher than they have contracted to sell to customers.

To determine the APC, the Commission attempts to balance:

- the risk of a systemic financial collapse of the electricity industry during an extreme market event is significantly reduced,
- compensation claims by market participants following an application of the APC are minimised, and
- market participants have appropriate incentives to supply electricity during administered price events and market signals for new investment are retained.

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