



23 January 2009

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

By email: [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au)

Dear Dr Tamblyn,

**Physical Market Cap Trigger Rule Change Proposal (ERC0075)**

Origin Energy (Origin) welcomes the opportunity to comment on the National Generators Forum (NGF) Rule change proposal. This proposal seeks to establish a price cap in the electricity market that would be triggered by certain non-credible contingency events.

Origin agrees with the NGF's assessment that the occurrence of certain disruptive power system (trigger) events has the potential to inflict significant financial losses on some generators in relation to their contracted position in the forward market. Given this, we are supportive of the development of mechanisms which assist affected generators in the management of this risk. That being said, we have some concerns as to whether the NGF's proposal is the appropriate means of achieving this end. We consider that the general concept set out in the Snowy Hydro proposal may prove more targeted toward affected generators while at the same time avoiding broader disruption to spot market signals. Our views are set out below.

***Distortionary effects***

Origin is wary of market interventionist mechanisms even if they are enacted only infrequently. We consider that the capping of the spot price is only justifiable in the context of a market failure. Market failure can be defined by an inability of the market to clear; for example, where supply is unable to meet demand regardless of the price. This can lead to sustained and very high prices which undermine the integrity and viability of markets. It is for this reason that price caps and risk mechanisms such as the Administered Price Cap and Cumulative Price Threshold are implemented. At this point, we are not convinced that the occurrence of a trigger event, as defined in the NGF proposal, constitutes a market failure because it is not obvious that such a trigger event will prevent demand from being met by supply sources other than those directly



impacted by the trigger event. Interference with price signals under these circumstances may undermine the ability of alternative supply sources to address the supply imbalance.

The electricity market is designed to facilitate the entry of peaking plant at times of tight supply/demand balance. Increasing the range of circumstances under which spot prices can be capped reduces opportunities for demand side and supply response, including incentives for peaking plant to enter the market. This is likely to impact on the economics of peaking generators which are dependent on higher spot prices to recover their costs.

In this regard, we are concerned that excessive intervention in normal price setting mechanisms in the absence of market failure will lead to wealth transfers between generators rather than net public benefits.

In order to satisfy the National Electricity Objective (NEO), the proposed Rule must provide some net improvement to the economic efficiency of the market and have long term benefits for electricity customers. Origin is not convinced that a strong enough case has been made as to how the NGF Rule would satisfy the NEO as it seemingly would only have the effect of shifting the distribution of benefits between generators in different locations.

More subtle unintended consequences may also eventuate from injudicious application of price caps. As highlighted in the NGF proposal, the occurrence of a trigger event in one region and the subsequent capping of the spot price could result in the implementation of price caps in other regions. This would be done to prevent the accrual of negative inter-regional settlement residues. The possible extension of the cap to other regions in our view increases its distortionary effects and could potentially lead to market suspension.

### ***Who pays?***

Market Participants that are adversely affected with the introduction of the NGF's proposed price cap would have to be compensated. The calculation of this compensation could prove complex, even more so, if the cap is extended to other regions. There is also the issue of who ultimately bears the cost of this compensation. The NGF's proposal would effectively allow for the smearing of the cost of compensation amongst Market Participants, which given the doubts regarding the overall benefits to the market, may not be wholly justified.

### ***Operational Issues***

The NGF's Rule increases the range of circumstances under which NEMMCO can intervene in the market as they will be responsible for determining when a trigger event has occurred and when the cap should be implemented. Our concern is that NEMMCO will have to make these decisions in real time, at a time when they are likely to already be under stress. For example, though the definitions of credible and non-credible contingency events are set out in the Rules, there might be instances where the distinction between the two is not entirely clear - at least immediately. This could result in the improper implementation of the price cap.



### ***Credible contingency events***

Some credible contingency events have the potential to cause generators significant financial distress. For example, the occurrence of two non-simultaneous credible contingencies could have a similar material impact on dispatch as a non-credible contingency event. It is not likely that the NGF's proposed Rule would be able to protect generators in these instances as the cap would only be triggered when a non-credible contingency has occurred.

### ***Snowy Hydro proposal***

Origin considers that the general concept of the Snowy Hydro proposal is a more efficient and administratively simple means of managing the risks associated with the occurrence of random disruptive power system events. It does not interfere with the smooth running of the market and provides for those likely to be affected by these events to also bear the cost of mitigation - by participation in the insurance fund.

Additionally, the Snowy Hydro proposal puts less stress on the market operator, as a decision to classify a trigger event does not have to be made in real time, and any compensation can be sorted out after the event has occurred.

### ***Alternative solution***

Co-insurance where two or more generators agree to cover a proportion of each other's capacity in certain circumstances, either physically or through cap contracts is a further alternative for managing the risks set out in the NGF proposal.

Please do not hesitate to contact me on (02) 8345 5250 or Steve Reid on (02) 8345 5132 if you wish to discuss any of these issues further.

Yours sincerely

A handwritten signature in black ink, appearing to read "Tim O'Grady".

Tim O'Grady  
Group Manager, Wholesale Market Development