

## Review of administered electricity price compensation arrangements

The AEMC has published the final report of its review of compensation arrangements following an administered price, market price cap or market floor price.

### The compensation frameworks in the rules

Wholesale electricity market spot prices in the National Electricity Market (NEM) can vary substantially. Occasionally, high demand for electricity or other unusual circumstances can result in these prices reaching very high levels.

Administered prices can be applied to protect customers from sustained periods of high prices. Administered pricing caps the spot price at a much lower level than the normal market price cap, for a defined period of time. This happens very rarely in the NEM: since market start there have only been five periods of administered pricing.

There is a small risk that administered pricing could result in some energy suppliers incurring a loss. This could reduce their incentives to supply energy, which may have reliability consequences for consumers.

Energy suppliers may claim compensation if they have incurred a loss due to administered pricing. The national electricity rules (NER) identify which participants may claim compensation and in what circumstances they may do so. The NER also establish what kinds of costs can be claimed.

The AEMC is responsible for administering these claims, while the Australian Energy Market Operator (AEMO) is responsible for recovering the costs of any awarded compensation from market customers.

### This review: our final recommendations

This review examined the provisions in the NER which set out the compensation frameworks, in order to make sure these frameworks are functioning effectively.

We have made several recommendations which are designed to improve the function of these frameworks. These recommended should help ensure that customers receive a reliable supply of energy at an efficient price.

Our key recommendations in this draft report are:

- **Definition of the purpose of compensation:** The rules should clearly define that the sole purpose of compensation is to maintain incentives for participants to supply energy during an administered price period.
- **Eligibility to claim compensation:** Participants should become eligible to claim compensation once the spot price has been capped by an administered price. They should remain eligible to claim until the end of the trading day. Participants may only claim compensation if they have incurred a net loss during this period.

Clearly defined compensation arrangements will help ensure that the lights stay on during periods of high demand, while helping to control costs for consumers.

- **Participants who can claim:** Scheduled generators, scheduled loads and scheduled network service providers should be eligible to claim compensation. Ancillary services providers should not be eligible to claim compensation.
- **AEMC claim assessment process:** We have recommended a number of changes to the AEMC's process for assessing compensation claims, including:
  - The AEMC should publish advice when a claim has been received and when formal commencement of the claim has started.
  - The AEMC should have discretion to appoint a varying sized expert panel, depending on the complexity of a compensation claim.
  - The AEMC should have some discretion to extend the period for assessment of a compensation claim, in certain circumstances.
- **Public consultation process:** We have recommended that a public consultation process is necessary for the assessment of opportunity cost claims. No public consultation process is necessary for direct cost claims.
- **Recovery of compensation costs:** The cost of compensation should be recovered from customers in the region where administered pricing applied, in proportion to their total energy consumption.

### Why do the compensation frameworks need to be reviewed?

To date, there has only been one claim for compensation in the NEM. This claim was from Synergen Power, for the operation of two South Australian generating units in early 2009.

While it was assessing this claim, the AEMC identified several problems with the existing compensation provisions in the NER. These issues related to which parties should be eligible to claim compensation and in what circumstances this was appropriate. We also identified issues relating to the AEMC's processes for assessing compensation claims.

Accordingly, at the conclusion of our assessment of the Synergen compensation claim, the AEMC identified that it would undertake a further, more detailed review of the compensation provisions to address these issues.

### Next steps

As required by the National Electricity Law, the AEMC has circulated a copy of this report to the Standing Council on Energy and Resources.

The NER will require amendment to introduce the recommendations made in this review. It is also likely that the compensation guidelines will require amendment. Amendment to both the rules and to the guidelines will include a public consultation process.

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Flexible and varying wholesale market prices are central to electricity market efficiency, as they provide a signal of changing demand levels and help drive efficient investment.

## Attachment 1: Operation of the cumulative price threshold, administered price period and administered price cap

The NEM is a gross, energy only market. This means that all electricity in the NEM is traded through the wholesale market. The wholesale spot market price is based on the bids and offers of market participants, with a new spot price determined every half hour.

Spot prices in the wholesale market cannot exceed the market price cap (MPC) of \$12,900 and cannot be any lower than the market floor price of -\$1,000 in any given half hour.

In certain unusual circumstances, such as very high levels of demand or a power system outage, the spot price may reach high levels. In some cases, the market price cap may be reached.

Occasional high prices provide price signals that support efficient investment, which contributes to the continued reliability of supply.

However, extended exposure to sustained high prices beyond a certain point would be increasingly inefficient. It may place substantial stress on market participants. This could have implications for the stability of the entire market.

The NER contains a series of mechanisms which are designed to prevent this outcome.

### The cumulative price threshold

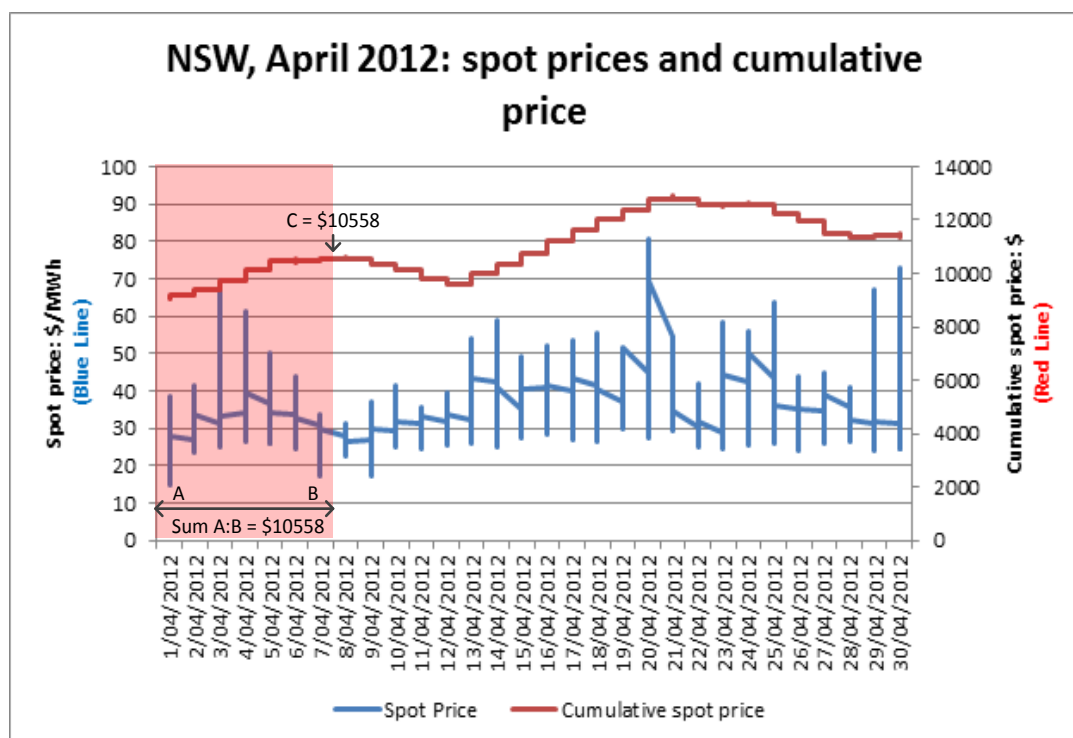
As discussed above, the spot price in any given half hour cannot exceed the market price cap.

In addition, the sum of these spot prices cannot exceed the level of the cumulative price threshold (CPT), within a rolling seven day period. Currently, the CPT is set at \$193,000.

Figure 1 below provides an illustration of how the cumulative price is calculated under normal market conditions.

In this figure, the red shaded area represents the seven day period between 12:01am on 1 April 2012 and midnight on 7 April 2012 – points A to B. Each of the 336 half hourly prices within this period are summed, resulting in a cumulative price of \$10558 at midnight on 7 April 2012 – point C.<sup>1</sup>

**Figure 1: calculation of the CPT under normal market conditions.**



<sup>1</sup> NSW in April 2012 was chosen simply because it was a relatively “normal” month, representing average market conditions. Later, we will examine a less typical period (January 2009 in South Australia), to show what happens when spot prices are much higher than average.

An administered price period applies from when the cumulative price threshold is first breached until the end of the trading day.

This process is continued on a rolling basis, with a new cumulative price calculated for each subsequent half hour period. For example, the cumulative price calculated at 12:30am on 8 April 2012 was equal to the sum of the spot prices for the preceding 336 trading intervals, from 12:30am on 1 April 2012.

**The administered price period and administered price cap**

Spot prices in the NEM are normally much lower than the market price cap.

However, spot market prices may change rapidly and can reach very high levels. This can result in rapid increases in the cumulative price. Once the cumulative price breaches the CPT, an administered price period is declared.

An administered price period applies from when the CPT was first breached until the end of the day. If the cumulative price remains above the CPT at the beginning of the next day, then the administered price period continues for that day.

During an administered price period, the spot price in the region cannot exceed the level of the administered price cap (currently set at \$300/MWh), or be set any lower than the level of the administered floor price (currently set at -\$300/MWh).

**Application of the CPT / APC: South Australia, January 2009**

Figure 1 above provides an example of typical spot and cumulative prices in the NEM. However, under specific conditions, spot prices can be much more volatile, potentially triggering an administered price period.

This situation occurred in South Australia in January 2009. A month of very hot weather in South Australia contributed to high levels of demand for electricity, which put upwards pressure on spot prices.

As shown in figure 2 below, spot market prices spiked close to the market price cap (then set at \$10,000/MWh) on 13 January and then again on 19 January, rapidly pushing the cumulative price to levels approaching the CPT (then set at \$150,000).

Spot prices spiked again on 28 January, driving the cumulative price back towards the CPT. At 15:30 on 29 January, the cumulative price breached the CPT and an administered price period was applied.

The administered price period continued until 4am on 7 February 2009, as shown by the green shaded area. During this time, the APC applied and the South Australian spot price was prevented from exceeding \$300/MWh.

**Figure 2: the CPT and administered price period**

