



21 December 2007

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

Dear Sir or Madam:

### **NGF view on Clarification of Schedule for the Administered Price Cap (APC)**

The National Generators Forum (NGF) appreciates this opportunity to comment upon the criteria to be taken in to account when determining the level of the APC. NGF members have considerable experience in the matter and have discussed and agreed upon the following views.

The APC is triggered by the Cumulative Price Threshold (CPT), so when considering the objective of the APC one must consider the objectives of the CPT and the likely physical circumstances of its application.

#### *CPT-APC objective*

It is our understanding that the CPT-APC mechanism was created to limit the exposure that participants may face from one market episode to a finite, yet relatively large, financial risk. The prime objective of the CPT is to avert a systemic financial collapse of the industry that might occur if many participants were to become insolvent. The financial risks in the lead up to a CPT trigger are however large to ensure the mechanism does not distort normal prudent risk mitigation and investment incentives.

It is our view that all necessary generator capital returns and other investment incentives should be earned in the period prior to the CPT triggering. We see the subsequent period of APC application as a form of market suspension- i.e. it should not be necessary to reward capital investment during this period and the primary goal is the limitation of residual financial harm. This observation leads to a view towards a low APC.

#### *Application Circumstance*

As the CPT trigger is purely price based, there is no distinction as to the physical cause of the market episode nor assessment of the loss bearers. Some examples of hypothetical CPT events are:

1. A period of sustained very high demand for which retailers have purchased insufficient hedging cover on aggregate;
2. A coincidence of independent generator unit forced outages causing sustained high prices and possibly load shedding.
3. Industrial action affecting a large quantity of generation;
4. A major and sustained interruption to the transmission network resulting in load shedding and VoLL pricing.

In all likelihood, the APC is likely to be applied through a period of physical stress on the power system, where load shedding is occurring or imminent, higher priced fuels are required to operate and demand-side response is being activated. This in turn leads to operational problems caused by a low APC:

- A large amount of generation will be bid with prices above the cap and will have a reasonable claim for compensation. This is administratively complex and market customers may have no way of managing the funding of large compensation claims.
- Generation may see the stressful physical period perversely as a period of low financial risk and may take opportunity maintenance. This in turn will require NEMMCO intervention to prevent.
- Non-scheduled generation and demand-side response cannot claim compensation. Such participants with marginal costs in excess of the APC will not respond and may in practice be impossible to direct-thereby increasing the level of mandatory load shed.

#### *Level of the APC*

The NGF recognises that selection of the APC is a difficult trade-off between the competing objectives of minimising financial risk whilst also ensuring a functional market operates when subject to the cap.

The NGF is unable to form a collective view on what the appropriate level should be. Members' views range between keeping the current levels to an increase of five-fold. Individual generators will feed their views in separately to the AEMC.

#### *Indexation*

We presume the level of the APC will be infrequently reviewed. Thus, whatever level is decided upon by the commission should have some indexation mechanism to ensure that the value determined does not inadvertently erode over time. An example would be to annually republish the values based on CPI, rounding to the nearest \$10 for simplicity.

Yours sincerely

A handwritten signature in blue ink that reads "John Boshier". The signature is written in a cursive style with a large, looping initial "J".

John Boshier  
Executive Director