# Presentation to AEMC on Physical Market Cap Trigger

**NGF** 

(except Snowy Hydro and Hydro Tasmania)

Ken Secomb

Ron Logan

#### Market Price Limit

- The Market Price Limit is subject to tension between competing objectives
  - It should be high enough to allow the price signals necessary to maintaining supply reliability, but
  - A high limit results in high risks to participants, adding to participant costs, and hence ultimately to consumer costs
- The Reliability Panel is faced with this tension

## Temporary lower price caps

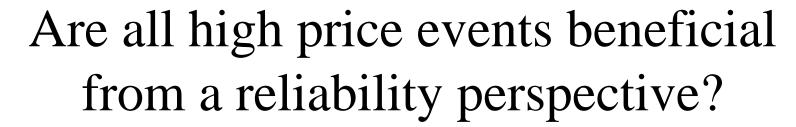
- The current market design already recognises the value of a lower price cap when the reliability issue is not at stake
  - A lower price cap (the APC) is applied when the cumulative reliability signal during a high price event reaches a defined trigger value
- This NGF proposal applies the same lower price cap, in this case under conditions when high prices are likely to occur, but would not contribute to investment for future reliability

#### NECA consideration

- NECA considered that some market risks should be mitigated and focussed on two risk mitigation measures –
  - Measures based on defined Force Majeure events (but they found it difficult to define these comprehensively), OR
  - Measures based on the market price outcome (which became the Cumulative Price Threshold/ Administered Price Cap provision, now in the Rules)

## This proposal

- The NGF proposes that the "OR" should be "AND",
- I.E. retain the existing mechanism, and supplement it with an event-based trigger
- The definition of events is much less critical if it is not the <u>only</u> risk-mitigation process; CPT/APC remains as a "backstop"



- NO; a prudent investor will not rely on the repetition of rare and unpredictable events to justify investment,
- Hence the normal need to have a high Market Price Limit, to support reliability, has little relevance to pricing during rare and extreme market events



- Contingency events that may affect the market are already clearly defined in the NEM Rules as either –
  - Credible contingency events, which NEMMCO must take precautions against, or
  - Non-credible contingency events against which NEMMCO has no obligation (or right) to take precautions

#### The NGF contention

- If a contingency event is so unlikely that NEMMCO is not required to take precautions against it, then
- Market participants are unlikely to treat any high prices resulting from that contingency event as a meaningful investment signal

## Reliability considerations

- The Reliability Standard defines the process for calculation of unserved energy (USE)
- Unserved energy resulting from a non-credible contingency event is <u>excluded</u> in USE calculations
- This distinction in the Reliability Standard between credible and non-credible contingency events, in the measurement of reliability, further supports the NGF contention

## Secondary conditions

- Non-credible contingency events may affect remote or unstressed parts of the network,
- These will have little or no effect on the market,
- Price capping would be inappropriate if the event has had no material effect on market dispatch,
- Materiality tests are included in the proposal, and are used as a secondary filter to confine price capping to appropriate events

## Characteristics of trigger events

- The trigger events that the proposal is designed to manage are rare and unpredictable, for example the disruption of 16 January 2007,
- But, there are some broad characteristics that may be foreseen -

# Trigger Event Characteristics (1)

- A significant network disruption event is likely to isolate some generators from the market,
- This is a lost opportunity for revenue,
- If an affected generator is hedged, then substantial losses may result
- While it is possible to imagine mechanisms to rearrange the incidence of this risk between participants, the <u>aggregate</u> risk would remain and ultimately be a cost to consumers

# Trigger Event Characteristics (2)

 Generators not separated from the market may be dispatched to high levels leading to high prices

• [but, as discussed above, such high prices are unlikely to have reliability benefits]

## Trigger Event Characteristics (3)

- If load is shed in a disruption event, then a retailer may be left over-hedged in relation to their remaining demand,
- This leads to a windfall gain related to both the magnitude of the load shedding, and the market price level

#### Requirements on NEMMCO

- Non-Credible contingency events are clearly defined in Rules
- NEMMCO has an existing need to identify contingency events, including non-credible contingency events, for the purposes of maintaining security and dispatching the market
- Impact on dispatch will generally be clear, but in any case can be easily calculated

## Summary

- The defined trigger events, if not managed efficiently, are likely to lead to unpredictable wealth transfers,
- These risks are not associated with reliability benefits,
- The cost of these risks will ultimately be funded by consumers, and hence
- The Electricity Objective is furthered by mitigating these risks