

## Review of administered electricity price compensation arrangements

The AEMC has published a draft 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.

In order to protect market participants from sustained periods of high prices, administered prices can be applied. These administered prices cap the spot price at a much lower level for a defined period. A more detailed explanation of how the administered pricing arrangements operate is included at the end of this information paper.

There is a risk that application of administered prices may result in energy suppliers incurring a loss, potentially reducing their incentives to supply energy. This could have serious implications for the reliability of supply of electricity to customers.

To deal with this risk, the national electricity rules (NER) allow suppliers of energy services to claim compensation, if they have incurred a loss due to administered pricing. The rules identify which participants may claim compensation, in what circumstances they may do so as well as setting out the kinds of costs that can be claimed.

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

### This review: our recommendations

The purpose of this review is to examine the provisions in the NER that set out the compensation frameworks and to make sure these frameworks are functioning effectively.

We have identified several areas where there are opportunities to improve the compensation frameworks. These improvements should help energy suppliers make better investment and operational decisions. They should also 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 primary purpose of compensation is to encourage participants to supply energy during an administered price period
- **Eligibility to claim compensation:** Participants should become eligible to claim compensation once the 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.

- **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:
  - We should publish advice when a claim has been received and when formal commencement of the claim has started.
  - We should have discretion to appoint a varying sized expert panel, depending on the complexity of a compensation claim.
  - We should have some discretion to extend the period for assessment of a compensation claim.
- **Public consultation process:** Public consultation is necessary for 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.
- **Retailer pass through of costs:** The existing processes do not impede retailers from passing through the costs of compensation to their end use customers

### **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.

### **Stakeholder consultation and next steps**

Input from stakeholders has been central to the development of our draft recommendations. All interested stakeholders are encouraged to provide comment in submissions to this draft report.

Submissions must be received by no later than 24 January 2013.

After having considered all submissions, the AEMC intends to deliver a final report and complete this review by July 2013.

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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 very high levels. In some cases, the market price cap may be reached.

These high prices are central to the efficient function of the NEM. They 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 NEM contains a series of mechanisms which are designed to prevent this outcome.

### The cumulative price threshold

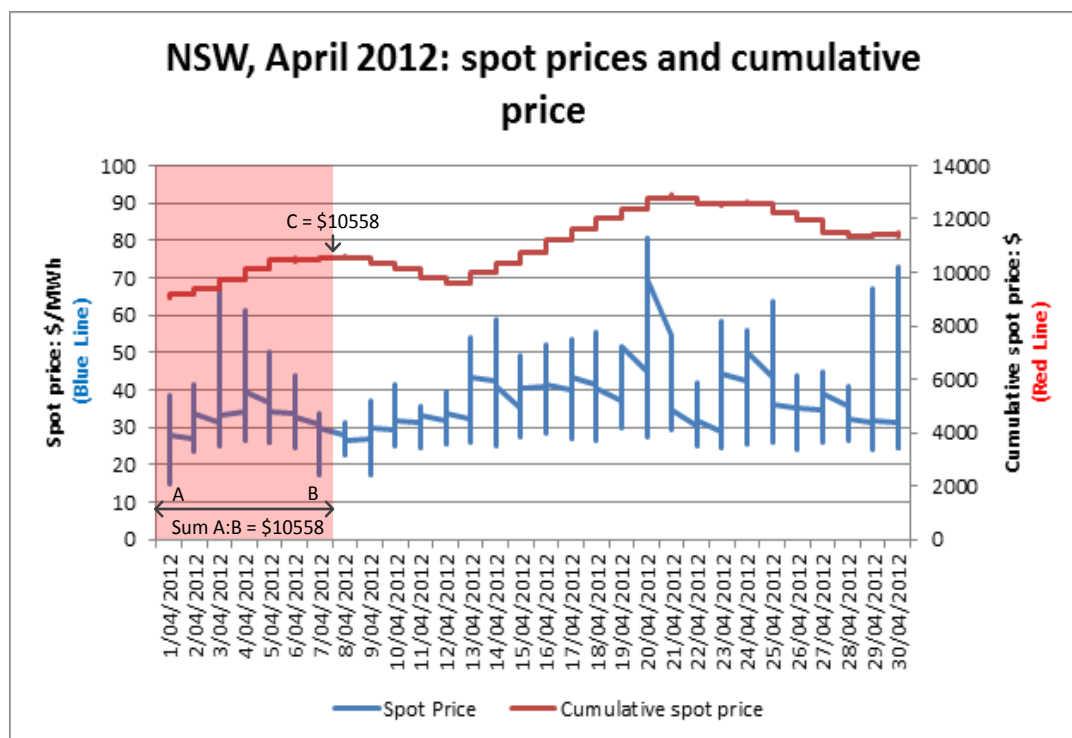
As discussed above, the spot price in any given half hour cannot exceed the market price cap.

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, 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; since July 2012, volume weighted spot prices have averaged around \$58/MWh.

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 2019, 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**

