



Australian Competition and Consumer Commission
Authorisation of National Electricity Code Changes
Capacity Mechanisms, VoLL and Price Floor

AGL Electricity Ltd (AGL) have reviewed the National Electricity Code Administrator's (NECA's) proposed changes to the National Electricity Code (the Code) that has been lodged with the Australian Competition and Consumer Commission (ACCC), and provide the following comments.

1. Capacity Mechanisms

In its review of capacity mechanisms, NECA proposes to replace the existing reserve trader provisions with a 'safety net mechanism'. Specifically NECA believes that the existing arrangements are unworkable and not effective under the situations in which they may be called upon. NECA cite an example whereby NEMMCO is currently obliged to delay intervention action to give the market every opportunity to respond to an emergency situation, and in doing so leave themselves too little time to invoke their 'reserve trader powers' thereby forcing them to rely on their 'powers of direction'. NECA go on to say that that ex ante arrangements, such as the reserve trader powers, or the safety net mechanisms, that are negotiated on a commercial basis in the market are less likely to introduce significant economic distortions in terms of planning and operational decisions.

The key changes to the reserve trader arrangements are:

- the supply and demand parameters to determine the necessary levels of capacity contracted as part of the 'safety net mechanism' will be determined by jurisdictional representatives;
- the service will be tendered in the open market with the payment of the service based on a 'fair market value' as determined by the jurisdictional representatives;
- an extension to the time horizon from six months to a rolling three year period; and
- the inclusion of a sunset date of 30 June 2003 with the Reliability Panel reviewing the necessity of the 'safety net mechanism' as part of its annual reviews of VoLL prior to this date.

AGL has a number of concerns with the NECA proposal. Specifically AGL is concerned that the jurisdictional representatives chosen will not have the necessary expertise to determine supply and demand parameters, or could be exposed to conflicts of interest. AGL is also concerned that the group of representatives may not be in a position to agree on what qualifies as low supply. In addition to this, jurisdictional regulators may not be in a position to determine what is a 'fair market value' for the above services. Should the jurisdictional regulators get either of these wrong then the price for the safety net will be higher than necessary and consequently be an additional and unnecessary cost to the market.

Tendering for the capacity in the 'open market' has the potential to raise costs with the number of generators willing, or able, to participate likely to be few, creating

problems of market power. Specifically, if capacity is not forthcoming through such a process, what options are available to NEMMCO to then contract for capacity to satisfy the requirements of the safety net mechanism? It is unlikely that NEMMCO has the commercial skills required to deal with such situations, and, even if it did, may not be in a position to negotiate effectively given the market structure.

Another related concern is that NEMMCO, by going to the market and tendering for capacity are either duplicating current contracts for capacity, or crowding out the private sector. The second scenario is of primary concern as the 'price' offered by NEMMCO may, be significantly higher than that which a commercial operator may be willing to offer. In the case where the capacity would have been made available to the market at the lower 'commercial' price, NEMMCO has in effect crowded out the private sector. Unfortunately, NEMMCO will still need to recover the unnecessary costs (the difference between the NEMMCO price and the more commercial price) from market participants, most likely the retailers and through to end customers.

One aim of the safety net is to encourage demand side bidding, and demand side management generally. AGL believes that the level of demand side bidding should not be used as an indication that a reserve trading function is no longer required. Those customers with the capacity to provide demand side bids may have commercial reasons for not participating in such a market (for example it may be in the customers best interest to participate in the ancillary service market).

2. VoLL

AGL understands that, in a contestable market, competitive forces should be free to determine price, which in turn provides the appropriate signals to both generators and customers (in terms of short term consumption and supply decisions, as well as longer term investment in generation or demand side management). However, this is not currently the case as there are insufficient number of suppliers in certain markets, such as the ancillary service market. In addition to this, customers do not have the ability to react at the same speed, or have access to the same level of information, as other market participants. Therefore there needs to be a price cap set in the market.

AGL's primary concerns are associated with the setting of VoLL and the process for applying an administrative price cap or floor.

- **Level of VoLL**

AGL supports a process where the value of VoLL is specified three years ahead with the third year subject to a review. However, AGL believes that moving to a value of \$20,000 per MWh without first having tested the value of \$10,000 is premature and may require the market to manage significant risks, which may ultimately prove costly to end customers.

- **Administrative price cap and floor**

Under the proposed arrangements, an administered price period is initially applied if the sum of the spot price in the previous 336 half-hour trading intervals exceeds the Cumulative Price Threshold (CPT), currently set at

\$300,000. Under this requirement the spot price would have to be, on average, \$1786 MWh for before an administrative price is applied.

As outlined earlier in this section, the role of the price mechanism is to provide the appropriate signals to both generators and customers. AGL questions whether an average pool price of \$1786 MWh over a one week period is required to provide appropriate signals to the market. Also, an administered pricing period is applied because the market is no longer functioning due primarily to the occurrence of a forced majeure event. By definition such events are unmanageable and unforeseen by market participants. It is therefore inappropriate that participants should be expected to manage such a market breakdown because the administered price period is not introduced until the CPT reaches \$300,000.

An average pool price of \$1786 MWh over a one week period has the potential to bankrupt a participant should they have even minimal exposure over this period. For the above reasons AGL believes that the administered price cap should be lower for a force majeure event.

AGL is also concerned that the potential exists for the administered price cap to remain in place for extended periods of time. Should the administered price cap be required for an extended period AGL recommends that a 'phase down' of the actual level be adopted. This recommendation is made on the basis that enforcing a price cap for an extended period of time does not enhance the price signal, and has the potential to bankrupt retailers and customers with even limited exposure to the wholesale price.