



Mr Peter Adams
General Manager Wholesale Markets
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Lodged via email: wholesaleperformance@aer.gov.au

Monday, 5 February 2018

Dear Mr Adams,

RE: Wholesale electricity market performance monitoring

ENGIE appreciates the opportunity to comment on the Australian Energy Regulator (AER) proposed approach to wholesale electricity market performance monitoring. This submission is in response to both the Approach to electricity wholesale market performance monitoring discussion paper, as well as the draft 2018 focus paper (Draft 2018 Focus).

ENGIE notes that the AER are commencing a process of regular monitoring and assessment of the structure and performance of the wholesale electricity markets, as required through recent amendments to the National Electricity Law. As noted by the AER in the Draft 2018 Focus, this monitoring program is commencing at a time of transformation within the energy sector, with the rapid emergence of new technologies and the need to address greenhouse gas emissions. As the energy markets in Australia come to terms with these transformative changes, ENGIE supports the AER in its role of maintaining a watchful eye on the performance of the wholesale electricity market to ensure that it remains workably competitive.

ENGIE believes it is important that the AER and the Council of Australian Governments Energy Council recognise that as the energy sector navigates its way through the numerous challenges presented by the energy transformation, that there is not an overly theoretical "text book" approach taken to the assessment of competition.

Wholesale energy only markets such as the National Electricity Market (NEM) are inherently volatile, and this is a fundamental and necessary element of an energy only market. It is through occasional price spikes that incentives are created for industry participants to enter into financial hedges, which in turn provide the mechanism through





which new investments are made. If these occasional high price spikes are artificially suppressed through policy interventions or overly zealous regulatory interference (noting that spot prices are already limited via the Market Price Cap), there will be an inevitable reduction in the amount of dispatchable and flexible generation. This is an important matter that is currently being reviewed by the Australian Energy Market Council in its Reliability Frameworks Review.

The inherent price volatility of energy only markets such as the NEM has led to ill-informed or ill-considered commentary (whether intentional or unintentional) that points to sudden high wholesale prices as evidence of market failure. Whilst the energy only NEM has always been somewhat vulnerable to these types of critiques, the current climate of political point scoring and ill-informed or biased commentary regarding the impact of variable renewable technology and climate policy has left the industry in a vulnerable state.

ENGIE suggests that all electricity industry stakeholders with a view to the long term viability of wholesale electricity markets in Australia would want to ensure that competition is healthy and effective in meeting the National Electricity Objective. To that end, ENGIE welcomes this program of monitoring and assessment by the AER, and looks forward to participating in the process.

It is quite possible that some aspects of the wholesale electricity market structure, conduct or performance will be identified by the AER as being below the level that might be regarded as ideal, and this provides an opportunity to enhance the NEM design and process, which is welcome. Nonetheless, several investigations in the past have shown that on the whole, the NEM is a robust and effective market mechanism that delivers efficient and competitive outcomes.

With the above overarching statements in mind, ENGIE provides the following brief specific comments on some of the points raised in the Draft 2018 Focus.

Structure

ENGIE notes that a large proportion of the Draft 2018 Focus document is dedicated to consideration of the market structure and market share. ENGIE also notes the various measures that the AER have flagged for use in its assessment of the structure of competition in the NEM including market share, Herfindahl-Hirschman Index and Residual Supply Index.

ENGIE understands that these measures, used in a considered manner, may provide useful insight into the structure of the NEM. As any economist understands, whilst the examination and study of what constitutes a perfectly competitive market has some value, there are virtually no examples of such perfection in the real world for any significant market. The nature of electricity markets, with their long investment timeframes, need to match supply and demand in real time and the essential need to maintain supply at all times all contribute to additional complexity and in some cases, the need to compromise from the ideal economic model.

In summary, ENGIE is broadly supportive of the approach proposed by the AER in assessing the structure of the NEM market as well as the ancillary service and derivative markets, provided that a practical lens is applied to the assessment which takes into account the physical, economic and political realities that shape the NEM.



Conduct

The AER have indicated it intends to focus its analysis on generator bidding and re-bidding behaviour and in particular the extent to which generators engage in economic or physical withholding. ENGIE agrees that in cases where it is clear that a generator is in a position of significant and sustained market power, and that generator then deliberately and significantly deploys that market power with a view to increasing the wholesale price above a level that would otherwise reasonably be expected, then these cases need to be called into account.

ENGIE is also mindful that there are a large number of complex factors that any generator participant needs to take into account when bidding its capacity into the energy only NEM. These factors go beyond those that are evident through examination of the NEM signals alone, and include other factors such as physical (e.g. fuel reserves, maintenance programs, operational limits, etc.) and financial (e.g. hedging contracts, commercial limits, expectations about the future, etc). To understand the extent and influence of such a wide range of factors, it will be important that any analysis goes beyond a simple examination of spot market bids and outcomes, and includes longer term and broader issues.

It would be improper of the AER to suggest it has a perfect understanding of what prices or actions should evolve in the absence of a participants observed behaviour within an isolated period of time, and then critique a market participant on the basis of this conceived counter-factual without reference to macro conditions and long term responses. To date, arguments attempting to suggest sustained market power far outnumber any actual instances of such sustained market power despite the ongoing focus on this topic.

ENGIE would therefore urge the AER to ensure it engages closely with the relevant participant to ensure that it has a complete understanding of all the relevant factors before reaching any conclusion regarding apparent anti-competitive behaviour.

Performance

ENGIE understands the AER's proposed approach of comparing the annual average spot electricity prices in each region with the levelised cost of energy (LCOE) associated with the investment and operation of the various generation technologies. It is important to recognise that although there should be ongoing excursions of the spot price that exceed the LCOE of certain technologies, long term trends are more insightful than short term excursions.

It will also be important that the AER consult widely in establishing values of LCOE for each technology category. ENGIE is aware that a range of LCOE values have been published for each technology, indicating a level of uncertainty in establishing a definitive value. ENGIE suggests that the AER apply a range of LCOE values for each technology, rather than attempt to establish a single value.

LCOE is not the only measure of estimating thresholds for measurement of pricing outcomes and investment triggers. During the AEMC process examining market power, which led to this reporting arrangement, the AEMC defined 'substantial market power' as 'the ability of a generator to increase annual average wholesale prices to a level that exceeds long run marginal cost (LRMC) and sustain prices at that level due to the presence of significant



barriers to entry. In such a framework, prices would need to bind above LRMC for a sustained period in order to incentivise investment. The AER would be wise to look at such measures in addition to LCOE.

Importantly, ENGIE and many market participants, have often indicated that barriers to entry is a key issue that requires consideration but seems to be a subject of less interest than speculative investigation of individual out turns in price. Ongoing activity in the purchase of existing assets and construction of new assets suggests that the case for barriers to entry might be weak. ENGIE assumes the AER will consider such questions as part of its monitoring approach and its ongoing reporting of market outcomes.

ENGIE trusts that the comments provided in this response are of assistance to the AER in its deliberations. Should you wish to discuss any aspects of this submission, please do not hesitate to contact me on, telephone, 03 9617 8331.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Chris Deague". The signature is fluid and cursive.

Chris Deague
Wholesale Regulations Manager