

Attention:

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INTRODUCTION

The Energy Users Association of Australia (EUAA) is the peak national body representing major Australian electricity and gas users. Our membership covers a broad cross-section of the Australian economy including significant retail, mining, manufacturing, materials and food processing industries.

The EUAA is a strong advocate for energy users and firmly believe that the primary objective of energy markets should be to serve the long-term interests of the consumer as stated in the NEO and NGO. There can be no doubt that energy users, both large and small are experiencing unprecedented increases in both electricity and gas costs while reliability of the system appears to be in some peril. This situation is clearly at odds with both the NGO and NEO.

Over the last 10 years Australia has given up its comparative advantage in competitively priced, highly reliable energy that has underpinned significant industrial development and employment for many decades. It is inconceivable to think that a country with resources that are the envy of the world cannot deliver competitively priced energy to its own population. If allowed to continue on this trajectory this comparative advantage will be permanently lost and along with it, a majority of energy intensive industry including many industrial, food processing and manufacturing industries.

THIS SUBMISSION

The EUAA welcomes the opportunity to comment on the approach the AER should take to monitoring the performance of the wholesale electricity market. Central to the operation of the National Electricity Market is confidence of all participants that it is fulfilling the National Electricity Objective of the long-term interests of all consumers. Expanding the existing, but limited, AER review roles will be an important step in having that confidence.

While the monitoring role is important to increase market transparency, we consider the ability of the AER to propose changes to the NEM rules to COAG Energy Council and to engage with AEMO and AEMC regarding their respective accountabilities as equally important.

We do not underestimate the complexity around measuring whether “effective competition” and “efficiency” exists. This is why we support the need for the AER to have a very broad canvas in how it assesses market performance.

No one tool or measure can describe a very complex market. It is not a matter of some simplistic conclusion like:

“The spot price over period x was \$Y/MWh and in a competitive market it would have been \$Y-Z/MWh”.

We prefer a conclusion in the form of:

“We observed a number of influences/constraints over the five-year period under review that we believe led the wholesale markets to not achieve what we would expect in an effective competitive market. These influences were ... and policy approaches to address these are ... “

This will involve a mix of quantitative and qualitative measures building the case for the conclusions drawn and recommendations made. These measures will change over time given markets and technology are evolving rapidly and monitoring needs to be adaptable to these changing circumstances. The AER needs to have discretion to be flexible in how it undertakes its monitoring.

The AER’s scope for its monitoring role should extend to any part of the “wholesale” market that impacts on the price paid by end consumers for their electricity i.e. spot, ancillary services, derivatives and system security measure like RERT. It should also be recognised that the relative importance of these are likely to change over time.

The EUAA believes that the NEM has considerable scope to improve its competitiveness and efficiency. We are of the view that the major factor in the NEM underachieving on competitiveness and efficiency is the lack of a co-ordinated policy and regulatory framework for generators to make their investment and operational decisions.

So, the initial ACCC report in December 2018 will be of a market that is probably operating at a 10th best level, rather than a 1st best “workable competitive” model. It may well be that we are achieving some degree of competitiveness and efficiency for a 10th best market, but that is of little comfort to electricity consumers. They need quick action to move it back up to 1st best which will require both coordinated and decisive policy action along with appropriate changes to the way the NEM is operated.

A key benefit of the AER monitoring will be increased market transparency. Hopefully this will lead to timely action on the proposed measures to improve competitiveness and efficiency. Of great concern and frustration is that consumers have seen large rises in network charges over the last 5-7 years and just when the rate of real growth in network costs has begun to fall, consumers now have large real increases

in the generation component of their bills. It took many years for changes in the network regulatory structure e.g. abolition of Limited Merits Review and a move to a binding WACC guideline, to begin to limit network price increases. We hope that it does not take as long to implement changes in the NEM flowing from this monitoring to see similar results in generation costs.

While the NEL provides for the AER to use publicly available information in the first instance for its market monitoring role, we would encourage the AER to consider seeking confidential information early in to the monitoring process. This can save time and help the AER to decide which matters to focus on as well as bringing additional insights.

The obvious precedent here is the monitoring role the ACCC has on the East Coast Gas Market. There were many reports over many years on this market, none of which were highlighting the issues our members were seeing as they sought to secure their gas supplies. It was only when the ACCC obtained confidential information were they able to conclude that the issues raised by gas consumers were valid.

Finally, we would support a formal mechanism whereby consumers have the ability to approach the AER with any concerns they might have about the wholesale electricity market performance.

Our response to the AER's specific questions are detailed in the Attachment.



Andrew Richards
Chief Executive Officer
Energy Users Association of Australia

ATTACHMENT – RESPONSES TO SPECIFIC QUESTIONS

Question 1: What material should we consider in establishing our approach?

All relevant material should be considered. This would include local and international experience and material developed in relation to the Major Energy User’s 2010 rule change proposal – not limited to that developed by the AEMC - and other reports by AEMO and AEMC.

Question 2: What factors should we consider when prioritising tools or analysis?

The net should initially be cast as wide as possible. We agree with the four criteria proposed to determine which measures, tools or information the AER will prioritise. These criteria will mean the measure, tools and information drawn on will change over time as markets change.

Question 3: What are the relevant products in the wholesale electricity markets? Are frequency control ancillary services (FCAS) and energy products part of the same or different markets?

Question 4: Given the interactions between spot and derivatives markets, to what extent should we incorporate monitoring and reporting of outcomes in derivatives markets?

Question 5: To what extent should we incorporate monitoring and reporting of interregional settlement residue rights (IRSRs)?

All “products” that have an impact on the whole electricity/generation component of the price paid by the end consumer should be included in the analysis. So, apart from the spot market include FCAS, derivatives (both OTC and exchange traded), IRSR, RERT and its replacement grid security mechanism.

It is likely that the relative importance, and hence AER focus, of these may change over time. For example, the FCAS market in South Australia would be a key part of any review of the South Australian wholesale market over the last couple of years, but it may not be in the future. The analysis should be able to make this assessment as required.

This is consistent with the AEMC and ACCC’s reviews of retail electricity markets where all factors associated with the final retail prices paid by consumers are considered.

Question 6: What are the factors we should consider when defining the geographic dimensions of the market?

Transmission constraints mean that the assessment should be by NEM region. This would include Tasmania as a separate region given the dominance of Hydro Tasmania. Consideration should also be given to looking separately at North vs SE Queensland.

Question 7: What are the factors we should consider when determining the relevant period of time for our assessment.

This may vary by product. It is perhaps the most difficult when considering spot markets. Fundamental to an energy only market is that prices will vary over time and on some occasions, will be well above a generator’s LRMC, let alone SRMC. Volatility is a central part of energy only markets.

The market price cap is designed to allow this volatility for investors to recover their “missing money” to give them their required rate of return. It is also designed to give a signal to potential investors that new capacity might be required. This means prices in efficient energy only markets will go in cycles depending on the demand/supply balance. These cycles could last a number of years.

The difficult question is - when are these high prices reflecting scarcity or temporal market power (and may be signal for new investment and indicate “effective competition”) and when are they a sign of sustained (and uncompetitive and inefficient) market power?

When is the exercise of temporal market power simply the energy only market operating as it should and when is it evidence of a fundamental problem in say the bidding rules that do not allow the energy only market to function as it should?

Over the past 12-18 months we are seeing spot prices that normally would have given a strong signal to new investment in synchronous generation but legal and regulatory barriers mean investors are not willing to take the risk on a long-term investment. This may provide existing synchronous generators with a temporal market power that is more indicative of inefficient market power.

A few years ago, generators were criticised for their bidding in the last 5 minutes of the 30-minute settlement period. This led to change in the good faith bidding rules and now to the proposed rule change to a 5-minute settlement period. In Queensland earlier this year the Queensland Government directed Stanwell Corporation to change its NEM bidding practices. This led to an immediate drop in spot and forward prices, greatest in Queensland and to a lesser extent in other NEM regions.

The advent of increasing renewables penetration has made deciding on the appropriate time period for assessing market power in the spot market much more difficult. Currently renewables are a partial competitor to synchronous generators for some products (e.g. generation at certain times of the day) but not all products (e.g. generation at night, ancillary services). This may change in the future however it is clear that the exit of synchronous generators has increased the market power of those remaining synchronous generators.

So, until renewables technology develops and battery/pumped storage expands, there will be large barriers to entry for the provision of ancillary services. This suggests a relatively short time period for the evaluation of market performance for ancillary services. For example, it appears to the EUAA that the high

ancillary services prices in the South Australian market, particularly when the Heywood interconnector was being upgraded, are more likely to be the exercise of market power than scarcity pricing in an effectively competitive market.

Question 8: What issues should we be aware of in applying the definition of effective competition in the National Electricity Law? Are there any additional matters we should consider?

Question 9: What factors can compromise efficiency in wholesale electricity markets?

A key issue here is the role of Commonwealth and State Governments – not as owners of generation assets that are subject to the same market rules as any other generator, but in terms of their direct intervention in the market. The prime example here is the South Australian Government’s “Our Energy Plan” which includes a state-owned gas fired power station, a state-owned battery and laws that allow the State Government to direct AEMO’s market actions. This type of action can have a range of negative impacts on market competitiveness and efficiency.

The AER should also consider the availability and price of coal and gas. Gas is now a major factor in the setting of spot prices and it required Government intervention through the Gas Supply Guarantee mechanism to ensure sufficient gas will be available for peak generation over summer 2017/18. There are also potential shortages of coal for summer 2017/18 e.g. due to concerns about mine closures or availability of volume and rail capacity given export market demand. These physical and contractual constraints are impacting on forward prices.

Finally, we would highlight the need to examine the impact of constraints on demand response that might support inefficient temporal market power.

Question 10: What market concentration indicators should we consider?

Again, the advent of increased renewables may make measurement difficult. Traditional measures of market concentration focus on market shares by firm capacity. This is easily applied to a traditional electricity market structure of large centralised generation. How can these measures take account of a market structure where there is diverse ownership of renewable generation that is all bid in at price e.g. zero, to ensure dispatch?

We recommend continuing the practice in the State of the Energy Market of using a range of measures and the development of measures to account for renewables bidding behaviour.

Question 11: What are the relevant sources of potential barriers to entry? What methods should we use to assess these barriers?

The current situation in the NEM means that there are huge barriers to entry for new synchronous generation, whether coal, gas or hydro, but very low barriers to entry for renewables.

In the case of coal, it is the investor risk perception built on legal and regulatory barriers. For gas, it is a structural barrier around the availability and price of gas. For hydro, it is a legal or regulatory barrier around the environmental approval process as well as simple the time required to develop and build new projects.

Assessment of these barriers is through discussions with potential investors.

Question 12: What are the issues we should consider regarding horizontal or vertical integration in the wholesale energy markets?

The EUAA supports the examination of the impact of both horizontal and vertical integration and particularly the latter. It needs to be satisfied that the risk mitigation benefits of vertical integration are passed on to consumers to balance any costs that this integration might have on market liquidity for exiting or potential new entrant generators.

Question 13: What aspects of a participant’s conduct should we consider? Are there any methods or tools that might be insightful for assessing conduct?

There is definite merit in extending the existing AER review of participant’s behaviour in high price events to a broader remit over a longer term. A key part of this would be the monitoring of wholesale contract liquidity and prices.

Question 14: How should we assess the overall performance of the wholesale markets?

We agree that there will be no one measure of overall market performance. There will be a range of qualitative and quantitative measures that will vary over time.

Question 15: How should we have regard to whether prices are determined on a long-term basis by underlying costs rather than the existence of market power?

In an efficient, competitive market prices over the long term will reflect the underlying costs (including “normal” returns) of the marginal generator. However, this is very difficult to then set up a benchmark to monitor against.

We agree with the limitations of both the LCOE and LRMC measures given different generation mix and different generator age. For example, in a competitive market, suppliers only recover their capital once. This concept has recently been applied in the COAG Gas Pipeline Information Disclosure and Arbitration Framework that applies to unregulated pipelines from 1st August 2017. On that basis, the LRMC for a more recently built generator might be higher than for an older generator of the same technology.

In summary, we agree that results from comparing actual prices to long runs costs are just one of a range of measures that can be drawn on.

Question 16: How can we identify inefficiencies in the wholesale market?

Question 17: How should we measure the extent of any inefficiencies we identify?

We agree with understanding the potential application of methods used in other similar markets e.g. Alberta. However again this is only one of a number of measures that should be drawn on, including the existing analysis of high price events.