Market Review and Competition Benefits Test Forum

An End-User View

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- The Regulatory Test

What Are They Good For?
Absolutely Nothing?

- Their impact on end-users
- Conclusions and Recommendations

(With apologies to Barret Strong, Norman Whitfield/Edwin Star)

Context

- Extreme volatility in energy price and ancillary service costs are not signs that the ***NEM*** is working.
- Volatility is caused by exercise of market power which is aided by an "inadequate" transmission system (and weak regulation).
- Volatility is artificial, not a sign of "real" scarcity.
- The UK has dealt with the same issues a whole lot better than we have.

Why this is important to end-users

- Australia depends on internationally competitive industries
  - many are energy intensive
  - it is unsound policy to damage these industries by not fixing "obvious" problems
- EUAA not opposed to energy markets
  - but do not support policies that risk damaging competitiveness
  - also need clear evidence that "the market" can sustain itself in long run without government intervention
- Australia must develop a coherent national approach to energy market development and Regulation.
- The UK has managed "federal" expectations (England, Scotland and Wales), why can't we? We still have 5 warring tribes.

Some volatility is (currently) unavoidable

- It is reasonable to expect some volatility in electricity price.
  - End-users with the most volatile demand receive absolutely no price signals.
  - End-users have inadequate access to easy, convenient and automatic load management infrastructure.
  - Production (and transport) cost is not constant.
  - Different consumers (likely) do assign different "value" to consumption – particularly of hot summer days.

Market Power

- "Unnecessary" volatility is a curse. It highlights the inherent inefficiencies with the NEM gross pool.
- Extreme volatility causes:
  - Substantial changes in contract prices from one contract period to the next.
  - Inability for large end-users to lock in long-term contracts at prices that allow us to compete.
  - Unacceptably high risk costs – that exceed any efficiency "dividend" from reform.
  - Lack of "cohesive" or timely signals for supply-side capacity investment.

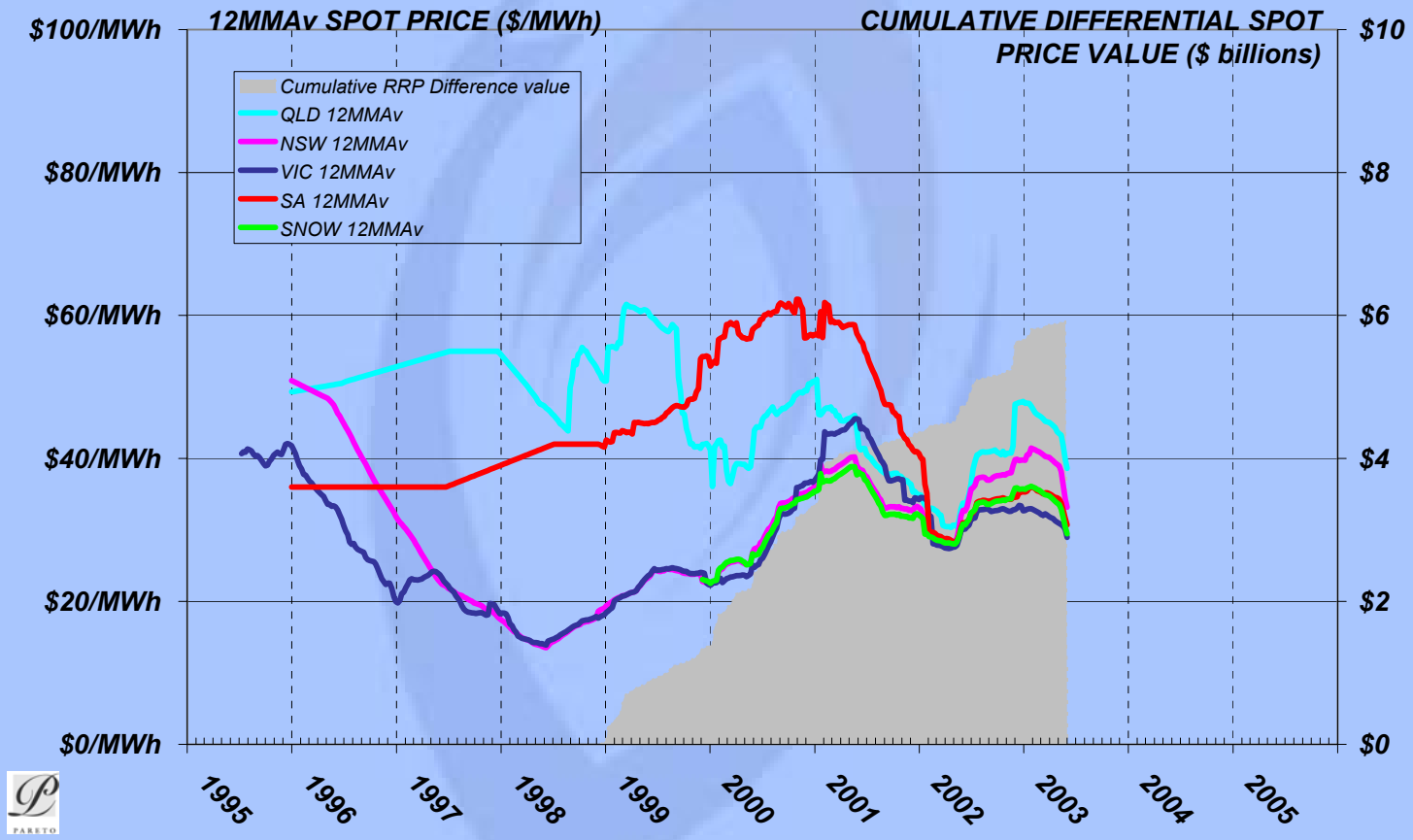
End-users can help do something about it

- The EUAA Demand Side Response Facility Trial showed large end-users can and will respond
- If enough did respond,
  - price might be capped at no more than 10% of VoLL and
  - Greater efficiency achieved in network investment.
- But the incentives have to be right
  - Hammering end-users with cost-reflective prices is not enough
  - If DSR delivers benefits, providers should be able to gain access to that benefit (and not "let" the supply-side capture the benefit)
- There is no reason, apart from regulatory inertia, why small consumers should be excluded.

Market Power and Competitiveness

- The NEM falls short on competitiveness.
- Regional prices differ markedly, driven by generators exploiting transmission constraints and exercising market power.
- No effective action by NECA or ACCC to fix either of these problems, leaving end users ‘short changed’.
- We have been talking about this for years - literally.
- OFFER and OFGEM have done a whole lot better.

What do we get for our money?



Costs of failed “regulation”

- Differential Regional Spot Price has cost end-users at least $6 billion since the NEM started.
- Price volatility risk can add 80-100% to the cost of retail energy.
- Meanwhile, NECA and the ACCC sit on their hands and do nothing but focus on detail.
- We cannot say we don’t know if we have a problem.

Let's Put This is Perspective

- End-users pay all the costs of the market and expect the market to deliver
  - Energy market turnover is around $7 bn/y
  - Network services cost ***end-users*** around $5.2 bn/y
  - The total cost to end-users at least $18 bn/y
- End-users have paid 100% of shared network costs that total >$22 billion since 1998
- End-users have paid all of the costs of managing risks created by poor market design.

End-users' conclusions

- Too weak treatment of market power issues
  - NECA happily reporting exercise of market power
- Piecemeal treatment of ***regulatory test*** "problems"
  - Up to six different reviews of issues related to the ***regulatory test*** (IRPC, MCE, NEMMF, ACCC, NECA (beneficiary pays), NECA (DB *regulatory test*)).
- Disjointed, poorly thought through logic
  - Cost-benefit analysis applied to 'welfare' economics in the ***regulatory test***; but
  - End-users pay ***all*** the costs for shared networks
  - Plenty of evidence that "cross-over" effects occur.

Recommendations

1. Follow the UK "model"
   - Provide adequate means for end-users and gencos to contract
   - Deal with market power effectively
   - Provide "real" incentives for NSPs to be efficient and serve consumers.
2. Either ditch the ***regulatory test*** or change it
   - It is misguided in its current form – and that will not change under the ACCC proposals.
   - If it must stay change it to an application of cost-benefit analysis to "straightforward" investment assessment from the point of view of the ***end-users who pay for shared network services***
   - Include the full benefit ***to end-users*** of increased competition that removal of transmission constraints would bring.
3. Provide "proper" incentives for NSPs to do the "right" thing – including effective incentives to support efficient DSR and deliver benefits to end-users.