



EnergyAustralia

LIGHT THE WAY

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Dear Mr Fox

**2017 – AER - Approach to electricity wholesale market performance monitoring
– Discussion paper**

EnergyAustralia is one of Australia's largest energy companies with over 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market (NEM).

We welcome the opportunity to comment as the AER develops a methodology for its new function in monitoring the performance of the wholesale electricity market. Given the preliminary stage of consultation, our submission focusses on the direction we believe the AER should take this new function and responds to some of the issues raised in the discussion paper and at the Public Forum on 6 October 2017.

Analysing market performance is complex and there are many ways that the AER could do this. The Discussion Paper seeks guidance on how best to approach this new function and how to add the most value. We believe that the AER can add the most value by leveraging the large volume of data that is currently published by the AER and other regulatory bodies to assess the effectiveness of the market. In particular, the annual State of the Energy Market report provides detailed information on participants and market structure and the AER's weekly *Electricity* reports and *Prices above \$5000/MW* reports are based on prices and bidding behaviour data. Rather than developing entirely new data analysis processes, it would be more efficient to enhance existing monitoring work such as the pricing reports. Further work could be done to analyse patterns of behaviour, rather than focussing on single events in isolation.

The potential scope of market monitoring is broad with multiple relevant markets, geographies and market attributes that could be considered for review. Given the complexity and resource requirements to thoroughly review each market for effective competition, we suggest that the most efficient approach will be to focus on the key areas. These target areas could be identified through a high-level review based on existing market information and supported by input from participants. This approach will minimise the regulatory burden on both participants and regulators.

Participants already supply large volumes of data to regulators, much of which can be used to assess wholesale market performance. We urge caution against embarking on a detailed assessment of business costs, as proposed by some stakeholders at the public forum. Given the complexity of assessing long run costs, the conclusions drawn from such an exercise would not necessarily be clear. For example, an assessment of generator costs is not straightforward as it would need to include specific information on a variety of contractual and logistic factors such as maintenance requirements, gas availability and take or pay clauses. Assessing these costs would be an impossibly large task for the AER to do with an accuracy. Many factors impact bidding decisions and comparing prices to marginal costs, as suggested by some stakeholders, would be a poor method for assessing the long run efficiency of market pricing. Further, such an exercise would place a large reporting burden on participants and a large resourcing burden on the AER, at the risk of no material findings if there is no specific issue being tested.

With regards to pricing, we suggest that an assessment of the long run marginal costs (LRMC) of new entrants provides the clearest indication of whether there is effective competition in the market. LRMCs for new entrants that are lower than current prices, indicate that there is an incentive for new entrants to enter the market and compete with existing generators, placing competitive pressure on incumbents. An LRMC that is higher than current price, indicates that existing generators are providing the most efficient service. This was the approach taken by the AEMC in their 2013 assessment of potential generator market power in the NEM.¹ While calculation of LRMCs requires assessment of an appropriate methodology and accessing detailed input assumptions, it is considerably more insightful and straightforward than looking at generators costs more explicitly.

To accurately assess the performance of the market, it is important to consider not just prices in the current environment, but these prices over a broad timeframe. Initially, the AER is only required to report on the most recent two years of market history. However, it is important that these two years are considered within a wider context to ensure erroneous conclusions are not drawn based on current performance. Energy prices experience peaks and troughs, reflecting investment cycles, and it is important that current prices are considered in this context as long run capital costs are not recovered in equal annual instalments.

Finally, a focus of the discussion material published to date has been on the behaviour of market participants, however, it is important to also develop a framework for assessing the impact that external factors have on market efficiency. Government intervention and policy changes can hamper efficient market operations by providing misleading signals for investment, unfairly favouring particular businesses and increasing uncertainty. All of these can create barriers to entry, deter investment and cause prices to increase. External factors the AER should consider include: government interventions, recent, or unexpected, policy changes, policy instability and repeated market interventions undertaken by AEMO. Any assessment of market performance should include an assessment of the tangible impacts these changes in the external environment have on market outcomes.

We value having a market that is effective and efficient at delivering reliable electricity to customers at low cost. Delivering affordable and reliable energy to all Australians is a

¹ <http://aemc.gov.au/Rule-Changes/Potential-Generator-Market-Power-in-the-NEM>

core pillar of EnergyAustralia's business and we wish to support the AER in their efforts to facilitate this. We believe that the most effective and efficient approach to assessing market performance will be to focus analysis on key areas of market where the AER, through analysis for other reports, or in consultation with stakeholders and other regulators, have concerns that market outcomes may be inefficient.

If you would like to discuss this submission, please contact Georgina Snelling on 03 8628 1126 or Georgina.Snelling@energyaustralia.com.au.

Regards

Melinda Green

Industry Regulation Leader