



Major Energy Users Inc.

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Dear Peter

Electricity wholesale market monitoring Consultation Paper and Draft 2018 focus

The Major Energy Users (MEU) welcomes the opportunity to provide its views to the AER on the consultation paper and draft 2018 focus relating to the AER approach to electricity wholesale market monitoring.

The MEU has already provided input to the AER development of its wholesale market monitoring process through previous meetings and forums and through a response to the Discussion paper released for comment in 2017. At both these meetings and in its response to the discussion paper, the MEU provided some observations and considers that the commentary provided is part of this submission to the AER.

Consultation paper

The MEU supports the very high level and flexible approach outlined in the AER update and consultation paper. The MEU agrees that a high degree of flexibility is required so that changes in the market can be adequately addressed without having to recast the framework.

As, in a competitive market, prices should reflect costs, we agree that the AER should use the levelised cost of energy (LCOE) measure in preference to the long run marginal cost (LRMC), due both to the difficulties inherent in assessing LRMC and because if the prices offered exceed LCOE, this is a primary indication that the market is providing insufficient competition and therefore allowing generators to increase their prices.

However, the MEU raises two aspects about the high level approach where the approach could be improved:

1. While the AER is proposing to use the LCOE to assess generator practices, the MEU considers that there is value in assessing the LCOE across each region. As mentioned in our response to the discussion paper, the MEU has observed that market prices seen by consumers (eg the spot and futures markets and retail price offerings) tend to reflect the cost of gas fired generation which is generally the marginal cost of generation, despite that a large proportion of the dispatched generation still comprises lower cost forms of supply such as from coal fired and wind generation¹.

If the AER develops an assessment of the regional LCOE, this would provide a guide as to the extent that the benefits of low cost generation are or are not being passed onto consumers. If it is apparent that the benefits of low cost generation are being retained by generators (either in their internal transfer pricing or offers to non-vertically integrated retailers, this provides an indication that:

- a) competition is not sufficiently strong
- b) “gentailers” are using their market power to maximise profits
- c) merit order of dispatch (ie higher cost generation is dispatched ahead of lower cost generation) is not occurring²

What ever the cause, it would show that the long terms interests of consumers are not being served by the market as it is structured.

If the LCOE of the region is lower than the average market spot price or the futures prices, this indicates there has been a possible failure in the market and deeper investigation would be needed. The MEU can see that if there a disparity between the regional LCOE and other averages becomes endemic, then a change to the market rules might be required to ensure that there is not an inappropriate transfer of wealth to generators and/or retailers at the disadvantage of consumers.

2. The MEU considers that the AER needs to have a forward looking focus on the market as part of the monitoring process. In this regard, the AER would assess known changes in the market to establish whether these will impact the levels of competition at which the AER considers is appropriate to deliver a workably competitive market. Such changes might include a move to a higher level of renewable generation at a

¹ In the MEU response to the Discussion paper, we highlighted that as much as 90% of dispatched generation on the mainland was from coal and wind generation, with relatively small amounts of gas fired generation.

² In the regard, under the “old” vertically integrated government owned electricity structure, generation costs were averaged for all forms of generation used, so that consumers paid an average price for electricity generation. Under the current approach, spot prices are set at the marginal price and this id=s the price consumers pay, rather than the average price of all generation. While the marginal price approach is appropriate for merit order dispatch, if a low cost generator can do so, it will force up the marginal price in order to maximise its benefit

national or regional level, new generation that has been included by AEMO in its forecasts, proposed generator closures, and changes to the rules (eg 5-minute settlement, introduction of the NEG).

While the MEU accepts that the AER would not have the power to prevent such changes, its monitoring and assessment would enable it to provide advice to the market and to the CoAG Energy Council, as to the competition effects of such changes so that there is the ability to address potential issues before they impact the market.

The MEU reiterates that the introduction of a reference group to provide the AER with guidance about aspects of competition seen in the wholesale market would be a valuable resource to the AER and has a lot to commend it.

Draft 2018 Focus

As with the update and consultation paper, the MEU considers the AER proposed approach is well thought out and appropriate. The MEU makes the following observations which it considers the AER should include in its 2018 review.

1. As noted above, the MEU considers that, as well as a review of the historic outcomes, the AER should include an assessment of known future changes to the market as part of its analysis. The AER makes particular mention of the introduction of the National Energy Guarantee (NEG) so an assessment of the NEG on the levels of market competition is expected to be part of the 2018 review but the impact of other known changes that should also be included in the review are:
 - a) the proposed closure of Liddell power station
 - b) the sale of Loy Yang B by Engie to Alinta
 - c) existing plant that has recently been added to the fleet
 - d) new generation that AEMO has included in its forecasts
 - e) the impact of the RERT usage on prices and competition
 - f) the impact of the SA battery on market competition
 - g) the introduction of the 5-minute settlement rule as the proposed AER approach would be based on 30-minute settlement and a change to 5 –minute settlement will impact the spot market, the futures market, the FCAS market and demand side offerings
 - h) the impact of state government changes to levels of renewable generation
 - i) other government involvement (eg the introduction by the SA government of stand by generation)

The MEU suggests that the AER report would not only assess the impacts of these known future changes but would highlight any concerns the AER has with regard the impacts on competition they provide arising from its investigations.

2. As noted in the MEU response to the discussion paper, the MEU is very concerned that, while vertical re-integration provides “gentailers” with the ability to internally hedge their position, it also impacts competition at the retail end of the market, as the majority of retailers have to access generation hedges from their competitors and there is limited competition in the wholesale market. With this in mind, the MEU considers the AER should carry out a confidential survey of second tier retailers who do not have their own generation to identify if there is a widespread concern about this aspect of vertical integration.
3. The MEU notes that the AER will not examine illegal misuse of market power as this is an ACCC concern. However, the MEU expects that the AER will refer any such instances to the ACCC for action.
4. While the MEU agrees with the AER that it should assess prices compared to LCOE for each technology (brown coal, black coal, gas, hydro, etc) but, as noted above, there should also be an assessment of the LCOE for a region (weighted by the amounts of electricity generated by each technology in each region over the period being assessed) to identify if the prices offered to consumers (eg spot price, futures prices and by retailers) reflects the weighted average LCOE for the region. If there is a disparity, this provides a view that generators and/or retailers are using their market power to raise prices above costs.

We appreciate the opportunity to have provided this input to this AER monitoring project. Should you wish for amplification of any of the comments provided in this response, please contact our Public Officer (David Headberry) on 03 5962 3225 or at davidheadberry@bigpond.com .

Yours faithfully



David Headberry
Public Officer

