



# **Major Energy Users Inc.**

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Mr Peter Adams  
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Dear Peter

## **Electricity wholesale market monitoring Staff working paper on LCOE**

The Major Energy Users (MEU) welcomes the opportunity to provide its views to the AER on the staff working paper about using the levelised cost of energy (LCOE) for its market monitoring program and which was released for comment as part of developing 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 and Consultation papers previously released for comment. At these meetings and in its response to the discussion and consultation papers, the MEU provided some observations and considers that the commentary provided in those is part of this submission to the AER.

The MEU notes that the AER intends to carry out its monitoring function based on assessments using LCOE. The MEU supports this approach as stated in the MEU response to the earlier consultation paper on this issue. The staff working paper explains how the AER might calculate the LCOE for a new entrant generator and will use this as the basis for assessing whether there is any exercise of market power occurring. The MEU supports the approach proposed for calculating LCOE in the staff working paper.

The MEU agrees that using the LCOE for a new entrant is an important part of monitoring the market performance, but on its own, this is insufficient. The MEU points out that the exercise of market power can occur even when there is no shortage of supply and to assess whether this is occurring requires the AER to develop a LCOE for each of the various types of generation that exist in each region of the NEM. The MEU has observed that in a highly concentrated market as exists in

each region of the NEM existing generators can use their market power to cause prices to rise above efficient prices.

In its preliminary report for its Retail Electricity Pricing Inquiry, the ACCC identified that each NEM region wholesale market is highly concentrated.

“Over 300 registered generators sell electricity into the NEM. The generation market is, however, highly concentrated.” (page 79)

“The high levels of concentration, and the very high market shares of certain generation businesses, raise real concerns. The effective operation of the NEM is predicated on a competitive market. The potential for the exercise of market power has increasingly been a concern as market concentration has increased.” (page 81)

As the ACCC report comments, the basis of the NEM is that there will be sufficient competition so that each generator offers its capacity at its short run marginal cost (SRMC), as would occur in a centrally dispatched market. If low cost generators do not offer their entire capacity at their SRMC and they are dispatched at bids above their LCOE, then this indicates that there is insufficient competition to achieve the goal of the market to deliver the lowest efficient cost for consumers.

While the AER investigates instances of high prices > \$5000/MWh, the MEU has seen where generators hold prices at much lower levels (eg just below \$300/MWh which is the price for caps traded on the ASX) for extended periods. Similarly the MEU has seen low cost base load generators economically withdraw capacity so that higher priced generators have to be dispatched. The outcome of such an action is that generators achieve higher revenues for less output than their SRMC would deliver and this is inefficient.

With the expected over supply of large generation certificates (LGCs)<sup>1</sup> issued as part of the Renewable Energy Target (RET), the MEU can even envisage wind generators reducing output in order to drive the regional prices higher so that the wind farms make more revenue out of higher prices delivered by higher SRMC generators.

The MEU points out that just using the new entrant LCOE for each generator type as the key point of comparison as to whether market power is being exercised, will result in two major concerns for consumers

1. Generators can keep prices just below the new entrant levels and make considerably higher revenues than is efficient from a consumer viewpoint. By comparing the market prices at various times to the LCOE of the various generators dispatched this will allow the AER to assess whether the generators are using their market power

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<sup>1</sup> Recognising that LGCs are a significant part of wind farm revenues

2. As has been seen in previous years, even if the market prices exceed the new entrant LCOE, it has been observed that there is a barrier to new entrants based on the fact that if prices are high because of the exercise of market power is seen to be the cause of the high prices, the new entrants will assess (sensibly) that entry to the market is not commercially sound<sup>2</sup>.

Keeping in mind the highly concentrated generation nature of each region in the NEM, the MEU considers that the AER needs to include comparison of the LCOE of each generator already operating in the market (or at least the LCOE of each fuel type of generator) to ensure that existing generators are not using their market power to increase revenues to the detriment of consumers. The prices bid by generators should not exceed their LCOE and if they do, this provides an indication that the generators might be using their market power to inefficiently increase prices.

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](mailto:davidheadberry@bigpond.com).

Yours faithfully



David Headberry  
Public Officer

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<sup>2</sup> This point is made in the recently released Grattan report “Mostly working – Australia’s wholesale electricity market”