



# Wholesale electricity market performance monitoring

**Draft 2020 Focus**

October 2019



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# Introduction

The AER has powers under the National Electricity Law (NEL) to undertake regular, comprehensive, longer-term assessments of the performance of wholesale electricity markets.<sup>1</sup> We will provide our biennial comprehensive report on the performance of Australia's wholesale electricity markets to the Council of Australian Governments Energy Council (COAG EC) in December 2020.

We will report on whether:

- there is effective competition in the wholesale market, or there are features of the market that may be detrimental to effective competition
- there are features of the market that may compromise the efficient functioning of the market.

This *2020 Focus* provides an overview of the context of the *Wholesale electricity market performance report 2020* (2020 performance report), the areas we intend to focus on in our analysis, and the framework and tools we intend to apply. The *2020 Focus* also sits alongside our enduring statement of approach,<sup>2</sup> which outlines the general approach we take in monitoring the performance of the market, including:

- the framework for our analysis
- how we define effective competition and efficiency
- the way we will collect and use information

In future reports, we expect the wholesale markets will evolve and the issues we focus on will change.

We have other reporting obligations across our wholesale, retail and network areas in addition to these functions. Our other wholesale reports generally focus on short term outcomes, compliance issues and individual price events. In contrast, this biennial report allows us to take a longer term view of the market, with a focus on competition and efficiency issues.

## Invitation for submissions

We invite interested stakeholders to make written submissions in response to our proposed areas of focus, or any other matters relevant to the development of the *2020 Focus*, by the close of business **25 October 2019**.

Submissions should be sent electronically to: [wholesaleperformance@aer.gov.au](mailto:wholesaleperformance@aer.gov.au)

Alternatively, submissions can be mailed to:

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<sup>1</sup> NEL, Part 3, Division 1A

<sup>2</sup> AER. [Wholesale electricity market performance monitoring - Statement of approach](#).

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We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. We request parties wishing to submit confidential information:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

We will place all non-confidential submissions on our website at [www.aer.gov.au](http://www.aer.gov.au). For further information regarding our use and disclosure of information provided to us, see the *ACCC/AER Information Policy*, June 2014 available on our website.

Enquiries about this paper, or about lodging submissions, should be directed to the Market Performance branch of the AER via [AERInquiry@er.gov.au](mailto:AERInquiry@er.gov.au).

## Consultation process

Our proposed engagement with stakeholders to develop our *2020 Focus* is set out in Table 1.

**Table 1 Indicative timetable for development of 2020 Focus**

Milestone	Indicative Date
Draft 2020 Focus published	4 October 2019
Written submissions on the draft focus close	25 October 2019
Final 2020 Focus published	27 November 2019

## 2020 performance monitoring

Electricity markets in Australia continue to transform, driven by technological change. As the existing large scale generation fleet continues to age and exit the market, reliability and security of supply continues to be of primary concern. A number of initiatives and reforms have been implemented or proposed to help address these concerns.

The Retailer Reliability Obligation presents new implications for the market, and may encourage growth in investment in dispatchable resources. Increased penetration of intermittent renewable generation is promoting development of storage technologies and the proposed implementation of a wholesale demand response mechanism could further affect market dynamics.

Into the future, work is also underway to determine what the National Electricity Market (NEM) will look like post 2025. This work aims to deliver changes to ensure the market framework remains fit for purpose to deliver outcomes for the long term interests of consumers.

Given the extent of change and transition in the energy sector, the current and future competitiveness and efficiency of wholesale electricity markets remain an important area of concern.

### The framework and tools we will use

We must monitor the markets to assess whether there is effective competition, and if they are functioning efficiently. The overall framework we will use for our analysis will be the structure-conduct-performance approach, as set out in our statement of approach.<sup>3</sup>

In our statement of approach we identified a number of measures to provide consistent analysis between performance reports. We prioritised these measures on the basis of robustness, accessibility, practicality and probative value. We will carefully communicate the use and interpretation of any additional tools we may use.

Should we release any special reports as part of our monitoring of the wholesale electricity market, we will also incorporate that analysis into the performance report, undertaking further work as necessary.

Separately, we must use publicly available information to carry out our monitoring functions in the first instance, but can request confidential information if we identify an issue. Our statement of approach identifies how we intend to address information gathering and confidentiality.

Finally, chapter 7 of the 2018 performance report identified a number of issues that required further monitoring and analysis.<sup>4</sup> We have used these in determining our areas of focus in 2020.

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<sup>3</sup> AER, Wholesale electricity market performance monitoring, Statement of approach, p 11.

<sup>4</sup> AER, Wholesale electricity market performance report 2018, p 63.

## Markets we will focus on in 2020

There are a wide a range of products and services we could consider in our analysis. In addition to analysing the wholesale electricity spot market, in 2020 we will also consider the following:

- Frequency Control Ancillary Services (FCAS) — The 2018 performance report found that FCAS costs have increased, partly as a result of the changing generation mix. In addition, lack of competitive pressure in some local markets contributed to increased FCAS costs. In the 2018 performance report we expected to see these conditions improve, so it is important we reassess them. Furthermore, examining competition and the efficiency of FCAS markets builds on our new function to report quarterly on FCAS outcomes. In our 2020 report we will highlight key trends and long-term outcomes we identify in our quarterly FCAS analysis.<sup>5</sup>
- Derivatives products — The 2018 performance report found that while the products traded on the Australian Securities Exchange (ASX) are public information, there is still limited visibility regarding bilateral over-the-counter (OTC) transactions. Due to this, it is difficult to quantify how liquidity in these contracts markets has changed over time. We will continue to look to improve transparency surrounding these markets, and where possible, we will analyse the performance of these markets and their effect on the wholesale electricity market.
- Demand side participation — The 2018 performance report found that there is limited market based demand response in the NEM, but its influence may grow over time. This was reinforced by market participants, who expressed an interest in developing demand side participation. We intend to assess the effect of recent and proposed reforms to integrate more demand side participation into the market. As part of this we will examine the impact of the Reliability and Emergency Reserve Trader (RERT) function, and its impact on market-driven demand side participation, which was raised in the 2018 performance report.
- Upstream fuel markets — The 2018 performance report found that generators had increased their offers at the same time fuel costs were increasing, but in some cases the increase in fuel costs did not fully account for the increased prices. Since 2018, the cost and availability of these key fuels, such as coal and gas, continue to fluctuate. As these are significant inputs, it is important we fully understand the extent that changes in upstream fuel markets are affecting outcomes in the wholesale electricity markets.

## Issues we will focus on in 2020

We have separated the issues we will focus on according to our structure-conduct-performance framework.

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<sup>5</sup> From 2020, the AER will be required to report quarterly on trends and outcomes in FCAS markets.



## Structural issues

Our 2018 performance report found that ownership in each region is concentrated, and a number of market outcomes appeared to be the result of a lack of competitive constraint. Accordingly, we will continue to examine the structural factors that may provide a competitive constraint on the behaviour of market participants, as well as those factors that may facilitate the exercise of market power. We will do this by considering and building on the range of structural factors identified in our statement of approach and used in the 2018 performance report.

The 2018 performance report found that the market is undergoing significant transformation, with a changing generation mix, and new products and markets emerging. In 2020, we intend to assess the implications of the changing generation mix for competition, particularly as a result of the increased penetration of renewable generation types. The 2018 performance report also noted that as the market continues to transform, flexible technologies are likely to play an increasingly significant role. As such, we are interested in examining the effect developments in flexible capacity and firming products are having on the broader market.

In addition, we will continue to monitor liquidity in contract markets and the impact of efforts made to enhance contract market liquidity.

## Conduct issues

Our analysis of participant behaviour in the 2018 performance report identified the offer behaviour of black coal participants in Queensland and New South Wales as an issue requiring further monitoring. Accordingly, we will continue to assess trends in offers from these participants in 2020. In addition, we intend to request information on costs from participants to inform our analysis in 2020.

## Performance issues

Our statement of approach identifies two possible approaches for estimating costs when assessing whether prices are determined by underlying costs in the long run. In the 2018 performance report, we used Levelised Cost of Energy (LCOE) estimates and found that price signals for new entry appear to be emerging. In 2020, we will continue to use LCOE estimates to analyse the relationship between prices and underlying costs. We also will explore using Levelised Cost of Storage (LCOS) estimates to encompass storage technologies.

The 2018 performance report also identified a range of potential barriers to entry, and impediments to efficient price signalling in the NEM. For 2020, we will continue to examine incentives and trends for investment in the NEM, particularly in flexible generation capacity. We may also consider the impact of reforms and policy developments intended to improve competition in the sector that have been proposed or recently implemented.