



Potential Generator Market Power

Draft determination released for public comment

The Australian Energy Market Commission (AEMC or Commission) calls for public submissions on its draft determination to not make the Major Energy Users' (MEU) rule change request.

The Commission determines that there is insufficient evidence of the existence of substantial market power to warrant the making of the rule.

The Commission's draft determination

In accordance with section 99 of the National Electricity Law (NEL), the Commission has made this draft rule determination in relation to the rule proposed by the MEU.

The Commission has determined to not make the proposed rule.

Reasons for the Commission's draft determination

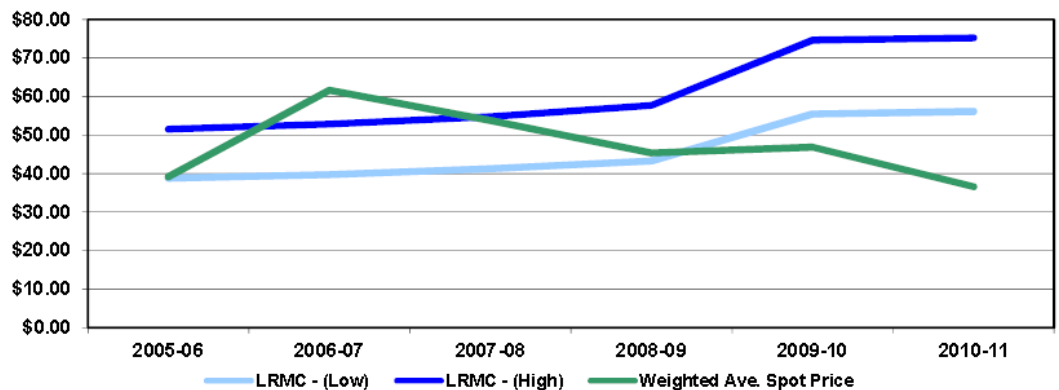
Based on the AEMC's analysis, consultant analysis and stakeholder feedback to the consultation paper, directions paper, public forum and technical paper, there is insufficient evidence of the existence of substantial market power to warrant the introduction of a rule that restricts the dispatch offers of generators in the National Electricity Market (NEM).

Evidence of substantial market power

To help determine evidence of the existence of substantial market power by generators in the NEM, the Commission engaged NERA Economic Consulting (NERA). NERA undertook analysis to determine whether generators had increased wholesale prices above that expected of an efficient and reasonably competitive market and had sustained those prices for an extended period of time.

NERA's analysis shows that annual average prices have on occasion risen above the efficient level but have not been sustained for a sufficiently long period that would warrant the making of the proposed rule. NERA's analysis also shows in recent years wholesale prices have fallen below the efficient level. The Commission considers that variations in annual average wholesale prices are to be expected over time and that NERA's results are reflective of a well-functioning market.

National Electricity Market weighted average prices compared with long run marginal cost



In addition, the Commission engaged the Competition Economists Group (CEG) to assess evidence of structural, strategic or legal factors that would prevent or inhibit new competitors efficiently investing in new generation in the NEM.

CEG found that in New South Wales, Victoria and Queensland there were no matters of significance prohibiting new generators from entering the market.

CEG noted that in South Australia, some aspects of the market, such as participant concentration, penetration of wind generation, and variable interconnector flows, meant that ongoing monitoring of prices against the long run efficient level may be warranted.

CEG's assessment of factors inhibiting new entrants in South Australia is not inconsistent with the findings by NERA that there is no evidence of the existence of substantial market power.

Definition of substantial market power

In order to analyse the rule change request it was necessary for the Commission to define market power.

Efficient wholesale prices should, averaged over time, be expected to be at the level required to recover the cost of building new generation or transmission capacity to satisfy growth in consumer demand. The Commission acknowledges that prices above this level for a sustained period of time may be more than is necessary to compensate for the various costs and risks borne by generators. If a generator(s) is able to increase average wholesale spot or contract prices above an efficient level for a sustained period of time, those prices are likely to flow through to retail prices and increase the costs to electricity consumers.

For short periods of time, transient but significant increases in the wholesale price of electricity may occur. A generator's transient ability to significantly increase prices for short periods should not be considered an issue unless that power is exercised to such an extent or with sufficient frequency that it causes long term average prices to be above the efficient level for a sustained period of time.

The MEU's proposed rule

The Commission considers that the MEU's proposed rule would restrict the ability of some generators to recover their efficient costs and would thereby act as a disincentive for new generators to enter the market or for existing generators to expand their capacity.

Any rule that seeks to constrain or limit the bidding of generators, in the manner proposed by the MEU, or a similar manner, is likely to diminish incentives in the current investment environment. Lower levels of investment are likely to reduce the long-term reliability of supply to consumers and increase prices as supply fails to keep pace with the growth in demand.

Future considerations

Extensive consultation has informed the framework adopted for the consideration of this rule change request. The Commission considers it is the appropriate methodology for assessing potential generator market power in the NEM.

The framework can be used by stakeholders to assess whether they consider there is evidence of substantial market power in the NEM in the future. In the case of any future considerations of this subject matter, the Commission intends to use the same set of assessment factors to determine the existence of substantial market power.

Before making any rule change to address future concerns about the existence of substantial market power it would also be important to understand the causes of the substantial market power. If the cause related to the industry structure of the wholesale electricity market in a particular region then a rule change may not be the most effective way to address the issue.

Submissions on the draft determination are due on 20 July 2012.

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7 June 2012