



1 March 2010

Mr Neville Henderson
Chairman
Reliability Panel
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Neville

Reliability Panel review of NEM reliability standards and proposal to increase Market Price Cap

I refer to the above and welcome the opportunity to put the views of the Energy Users Association of Australia's (EUAA) views to the Panel.

The EUAA is the national association of energy users in Australia and has taken a strong interest in NEM related issues since before the inception of the market, including previous reviews by the Panel and proposals to increase the market price cap. This includes previous submissions to the Panel (and others) on the level of the Market Price Cap (MPC).¹

The EUAA has around 100 members, including many of the nation's largest energy users. These organizations will see the impact of any decisions by the Panel, including increases in the MPC.

Users want competition and reliable supply. We are not convinced that an energy-only market will deliver these outcomes, particularly in light of climate change policies that result

¹ See for example, EUAA, *VoLL and the Cumulative Price Threshold in the National Electricity Market — the User Viewpoint*, Submission to the Reliability Panel of NECA, 25th February, 2004 and EUAA, *Response to AEMC Issues Paper of 11 May 2006 Comprehensive Review of Reliability Standards*, 10 July 2006

in transformational investment requirements. We made this view known to the AEMC during its review into Energy Markets in Light of Climate Change Policies. The AEMC did not provide evidence to allay our concerns, but noted instead that its terms of reference excluded a review of energy only markets, and asserted that there was no issue to be heard anyway.

Regarding the Reliability Panel's current review, we comment only on the issue of Unserved Energy (USE) and the Market Price Cap (MPC). We had intended to make a more all embracing submission responding to the Panel's Issues Paper and to participate in the Panel's public forum. We made an application to the Advocacy Panel to fund this work, which was supported by a number of other user/consumer organisations. However, the Advocacy Panel did not approve our application and this has resulted in a more limited contribution to this review using only those resources we have available in-house. We are very disappointed in this outcome and draw it to the Reliability Panel's attention.

We note that the Panel has not expressed a position in relation to the matter of the future level of the MPC in the Issues Paper and welcome this. We also note that ROAM Consulting, based on modeling of the NEM they undertook for the Panel have drawn a conclusion that, based on this modelling, the MPC could be increased from the current level of \$10,000/MWh to \$20,000/MWh, but since modified to \$16,000/MWh.

With this in mind, we submit the following points for the Reliability Panel's consideration:

- Raising the MPC is more likely to increase, rather than reduce, wholesale market price volatility. Higher volatility encourages vertical integration and discourages new suppliers and independent power producers from entering the market. Weakened competitive pressure from prospective new entrants will, over time, lead to higher prices, less innovation and worse service. .
- A higher MPC is likely to provide stronger incentives for the entry of low capital cost but high variable cost peaking plant that is able to recover its running costs and fixed costs by producing electricity in a rare few, very high priced settlement periods. We are skeptical that this is necessarily an efficient outcome. Efficient investment requires a mix of plant, appropriately adapted to the shape of the load duration curve. Simply raising MPC to encourage ever greater peaking capacity entry may be stimulating an inefficient generation mix, which results in higher average costs for users. ,
It is not clear to us that raising the MPC is needed to meet Unserved Energy (USE) objectives. Very high levels of the MPC can be expected to deliver a "peaky" price distribution curve (i.e. a very small number of settlement periods in which prices rise to very high MPC). By contrast, lower levels of MPC may be expected to produce flatter price duration curves, i.e. prices reaching the level of the lower MPC for more trading intervals, perhaps substantially more, but with much lower price volatility). It is therefore not obvious that a higher MPC leads to lower USE. If the lower MPC delivers average prices in those peaking periods that are sufficient to attract appropriate peaking generation, then USE need be no higher than it would be with higher MPC. In other words, raising the MPC is at best a blunt instrument to ensure security of supply, and at worst stimulates inefficient investment for no improvement in supply security.
- We are also concerned that greater volatility in spot markets via an increased MPC exacerbates the abuse of market power. This is especially the case in South Australia and Tasmania, two NEM regions where the Australian Energy Regulator (AER) has recently expressed concerns about the exercise of market power.²
- The Panel has suggested that a higher MPC would encourage hedging. We presume this is a reference to the idea that market participants are more likely to buy price hedges in

² See Willet, Ed, ACCC & AER, *State of the Energy Market*, Energy 21C Conference, 8 September 2009

response to more volatile prices. This seems to confuse cause and effect: more volatile prices will indeed stimulate greater desire to hedge price exposures, but this can be no guarantee that such hedges are achieved through the purchase of contracts. To the contrary, the empirical evidence in Australia strongly suggests that participants have sought to hedge price volatility through vertical integration. This has reduced – not increased – contract market liquidity. An ever diminishing pool of contracts in the contract market creates greater opportunity to exercise market power in this market, which in turn creates even stronger incentives for vertical integration. To return to our first point, increasing the MPC is simply likely to drive vertical integration even further, thus reducing contract market activity and raising barriers to entry.

- Electricity market design is not a peculiarly Australian issue. We suggest that the Reliability Panel should investigate the market price limits applied in electricity markets in the US, Scandinavia, Holland, Germany, New Zealand and Britain. To the best of our knowledge, none of these have an MPC anywhere close to as high as the NEM. The obvious question for the Panel to consider is why Australia needs such a high cap and what are its relative costs and benefits?

In summary, we do not support further increases in the MPC. In fact, there is evidence that the current level of MPC is already needlessly high. We can see no justification for further increases and suggest that they would have detrimental impacts on the market, on the health of competition in the market and on energy consumers. These outcomes are contrary to the Electricity Market Objective that should guide the Panel and AEMC's work. We understand that a number of other interested parties to this review have expressed their concerns about the impact of increasing the MPC and do not support it.

We encourage the Panel to consider our submission.

Yours sincerely

A handwritten signature in black ink, appearing to read "Roman Domanski". The signature is fluid and cursive, with a prominent loop at the end.

Roman Domanski
Executive Director