



AEMC Directions Paper Potential Generator Market Power

NGF preliminary views

- Agree with much of the Discussion Paper
 - AEMC has set out a framework broadly consistent with the Frontier Economics paper – ‘workable competition’ the key
 - Focus on longer term investment response
 - Higher pool prices are a necessary signal for new investment
 - Transitory price spikes do not merit intervention
 - Barriers to entry as important as any assessment of costs and prices

MEU Rule change proposal

- Onus of proof rests with the MEU
- No analytical framework to demonstrate case for change
- Selective use of half-hourly spot prices in a region does not make the case – periods of low or negative prices
- MEU proposal focuses on international markets – not relevant to the NEM
- MEU does not consider the role of hedge contracts

Some general concerns

- AEMC intends to apply an empirical test of whether there is a problem
- Questions about how the test is defined
- Should not rely on a single formula in making any recommendation – “convicted by modelling”
- Difficult to see how the AEMC could model or predict future behaviour and prices - “likely to be able” – no precedent for defining market power so broadly in Australian competition law

Barriers to entry

- Could argue that this should be the first “filter” – source of potential market power
- Sunk investment is not a barrier to entry - many industries where there are large, lumpy, long-lived, irreversible investments
- Barriers to entry only a problem in a market where there are specific factors that give advantages for “insiders” over “outsiders”
- AEMC could have given insights into those types of barriers it may have concerns about

Measuring long run marginal cost

- Calculation of a system LRMC is not easy
 - A range of methods and a degree of subjectivity in choice of technique
 - Should not rely solely on the results of one measure – “convicted by modelling”
 - Price post entry is important to an investor – average wholesale prices do not reveal whether new investment is viable
- Time-frame is crucial
 - Any assessment should take place over 5 years or more – inline with the timeframe for most new investment

SSNIP test

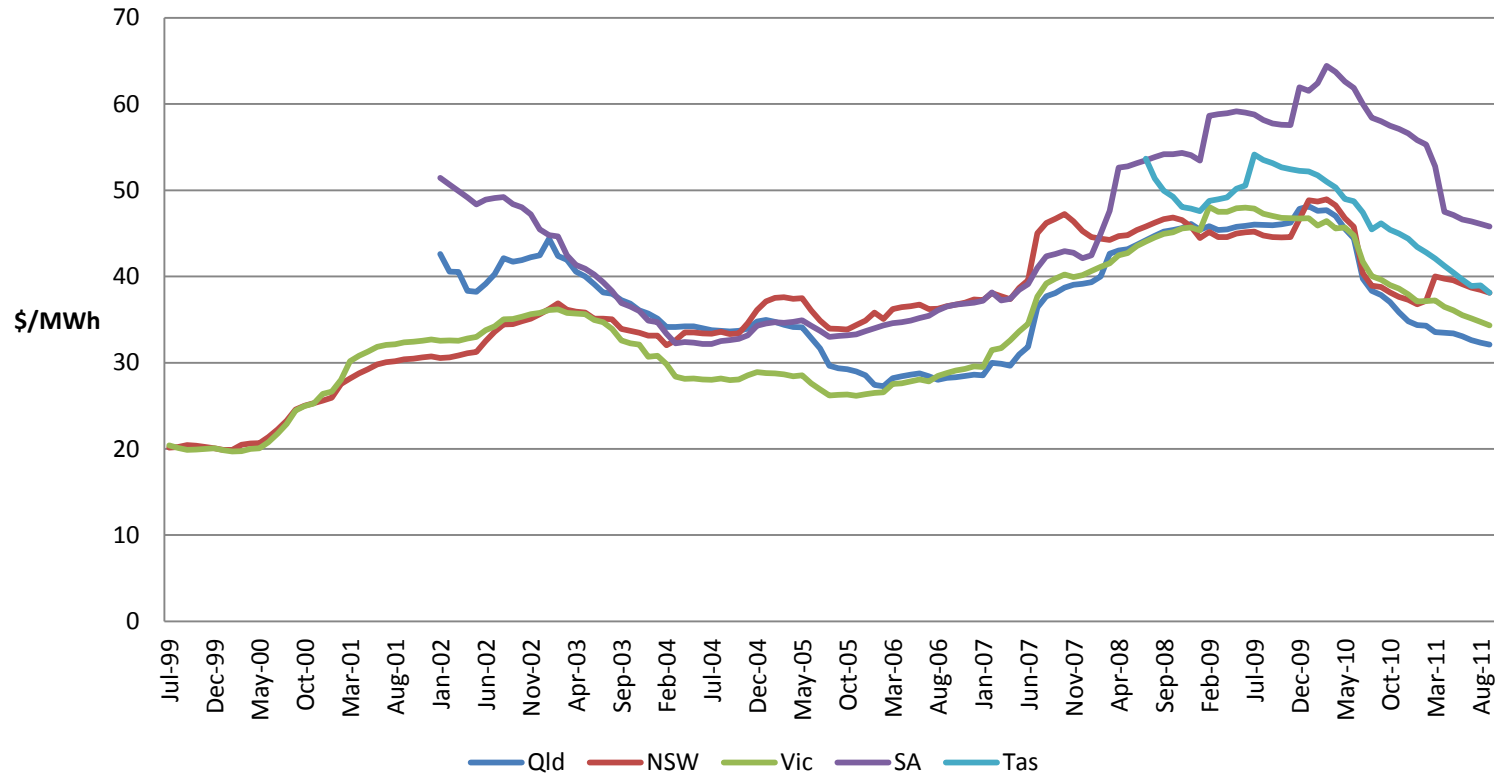
- SSNIP test of a hypothetical monopoly in each region likely to be misleading
 - Ignores any intra-regional generation competition
 - Time frame of 1 or 2 years too short
 - 5% is not material
 - Should also recognise possible demand side response
 - Inter-connector upgrades

Price drivers

- Short term price spikes the result of many factors
- Load factors, fuel costs, generation mix, prolonged periods of high demand, entry of renewables
- At a glance, the following chart indicates that prices have been relatively low and stable over time
- Only substantial increase the result of severe drought conditions

Average prices over the last ten years

3 YEAR ROLLING AVERAGE NEM REGIONAL REFERENCE PRICES



Initial thoughts

- AEMC has made progress in defining market power
- LRMC is difficult to use in a bright line test
- Concern at a simplistic test for a complex issue
- Barriers to entry the most important part of any analysis
- We still have concerns about the precedent of assessing the National Electricity Rule in matters that cover competition regulation