



International Power Australia

Updated Submission to the
AEMC Potential Generator
Market Power ERC0123

1st June 2011

1 Introduction

- 1.1 International Power entered the Australian energy industry in 1996 and has grown to become the country's largest private energy generator, with assets in Victoria, South Australia and Western Australia.

In February 2011, International Power combined with GDF SUEZ's energy assets to form a world leader in independent power generation, with more than 66 GW of power generation worldwide.

- 1.2 Definitions for words and expressions used in this Submission are contained in Section 14 of this Submission.

2 Summary

- 2.1 It is submitted that the MEU Rule Change Request is not consistent with the NEO, taking into account the key elements of the definition of the NEO being:

- (a) the promotion of "*efficient* investment"; and
- (b) recognition of the "*long term* interests of consumers of electricity" (emphasis added).

The MEU Rule Change Request is an example of ill-conceived short term regulatory manipulation in relation to price and capacity and will be adverse to long term interests of consumers of electricity because it will deter investment and lessen competition. It is economically efficient investment that promotes long term effective competition and this is an implicit element of the NEO. The MEU Rule Change Request is in direct contrast to both established principles.

- 2.2 The proper application of competition policy means that it is the combination of new entry or increased participation of existing participants in response to market signals and the continuing threat of new entry or increased participation, that represents a significant constraint upon the behaviour of incumbents in a market. The MEU Rule Change Request invites a form of short term regulatory intervention that takes no account of a concept of "workable competition" or "effective competition".

- 2.3 Clause 3.1.4(b) of the Rules provides that Chapter 3 of the Rules "is not intended to regulate anti-competitive behaviour by Market Participant ...". However, it is the stated purpose and object of the MEU Rule Change Request to implement a Rule change which is intended to regulate behaviour which the MEU has branded as "anti-competitive".

It is submitted that the AEMC cannot ignore clause 3.1.4(b) or make a decision that it now intends to revoke the stated object of Chapter 3 of the Rules and perform (or to confer powers on the AER to perform) functions in relation to "anti-competitive behaviour by Market Participants". To do so would be a complete reversal and restatement of the objects and purpose of Chapter 3 of the Rules.

- 2.4 The MEU Rule Change Request focuses on short-term effects and takes no account of long term considerations or assessments (whether in relation to market definition, market power or competition generally) or the significant and inevitable direct and consequential distortionary effects short term regulatory intervention and manipulation will have upon matters essential to timely new investment in response to market signals.

In fact, a fundamental misconception that goes to the heart of the MEU Rule Change Request is that it chooses to ignore long term considerations across all elements of competition and

markets and the methodology for assessing the effect or likely effect of behaviour or other conduct upon competition in a market.

The ACCC has accepted the relevance and application of long term principles in the context of the NEM.

2.5 The MEU Rule Change Request provides for regulatory intervention to address a perceived misuse of market power, with particular reference to the South Australian region of the NEM. However, it fails to identify and analyse any of the following:

- (a) There is no analysis of market definition, including the necessary component of the “future market”. No reference is made to, or assessment attempted in relation to, the need to identify sources of actual and potential competition and substitutability or the dynamic, evolving and expanding characteristics that must be taken into account.
- (b) Fundamental and established concepts of market power and the use of market power appear to have been overlooked. The concept of sustained and persistent behaviour or activity without constraint on a long term basis has been applied consistently by the courts in Australia. The concept of “transitory market power” has been rejected.

In addition, even if a firm possesses market power, it must not be assumed that conduct it engages in represents a use of that market power. If that conduct would have been engaged in by that firm whether or not it had market power, engaging in that conduct does not represent a use of market power.

2.6 The structure of the MEU Rule Change Request is arbitrary in nature and has no flexibility to address market dynamics, conditions and trends. For example:

- (a) The proposed definition and identification of a “dominant generator” takes no account of the question of whether that generator has a sustained and persistent ability or incentive to behave in a manner unconstrained by the relevant market.
- (b) It is assumed, in an arbitrary manner, that circumstances, events and trends that are characteristics of the market represent, or are the result of, strategic behaviour by certain generators. There is no recognition of the fact that a response to market conditions may well not be evidence of market power or a use of market power.
- (c) Although the MEU considers section 46(1) of the CCA to be inadequate because “the generators’ actions are not motivated by an anti-competitive purpose”, the MEU is seeking the introduction of a Rule that is not directed towards anti-competitive purpose or anti-competitive effect. It is directed towards nothing more than the arbitrary imposition of a pricing constraint and a capacity direction upon a “dominant generator” if a particular event occurs. That event, in itself, is arbitrary.
- (d) The arbitrary nature of the MEU Rule Change Request is exacerbated by the fact that it will also impose a requirement for consequential regulation, estimation and evaluation, including in relation to:
 - (i) the question of whether a “dominant generator” has dispatched, or offered for dispatch, all of its available capacity at the “dominant generator price cap”;
 - (ii) the question of whether the “dominant generator” has offered all of its available capacity to the market and how that is to be identified and measured;
 - (iii) the question of whether a “dominant generator” in any one year will continue to be so declared by the AER in the following year, taking into account the

effects of the regulatory restraint upon that “dominant generator” together with the fact that other generators may well take advantage of that regulatory restraint and be at risk of being declared as “dominant generators” in the following year;

- (iv) the proposal that if the AER considers that a “dominant generator” has not offered all of its capacity to the market, “then the AER will recover the windfall profit from the dominant generator which will also be fined as well”; and
- (v) the fact that the MEU Rule Change Request identifies “potential areas for derogations”.

2.7 It is implicit in the MEU Rule Change Request that existing regulatory oversight and governance is inadequate and that matters of market structure must be addressed by an ex-ante form of short term intervention. It is submitted that there is no basis for the MEU to assert that the powers conferred upon the AER and the ACCC in respect of the NEM are inadequate. In this regard, it is relevant to note that that in the context of the South Australian region of the NEM, the ownership of Torrens Island Power Station was approved by the ACCC pursuant to its informal merger review process for the purposes of section 50 of the CCA.

3 Energy only market design

- 3.1 In order to achieve market sustainability, generators must have a reasonable prospect of achieving returns on their investments.
- 3.2 Generators receive revenues from contracts and the wholesale electricity pool (“spot market”). The “contract market” is strongly correlated with the “spot market” and will not be sustainable in the absence of the “spot market” being sustainable. For this reason the following discussion focuses on the “spot market” outcomes.
- 3.3 The electricity system requires reserve capacity margin to maintain reliability. However the EOM design does not directly reward capacity. The revenues generators earn are derived from dispatched generation, and to a lesser degree from the provision of ancillary services.
- 3.4 Generators rely on intermittent high prices to contribute to their fixed costs (capacity) and to derive a return on capital.
- 3.5 There is a consensus amongst electricity market experts that the EOM is a fragile construct as it requires what the commentators describe as “situational market power” to achieve sustainability. The market price cap serves to limit the impact of the “situational market power”, but needs to be sufficiently high to attract new entrants. Thus the “spot market” price spikes and volatility are essential to drive investment in an EOM, as is the exercise of intermittent, short-term “situational market power”.
- 3.6 The current NEM design also has an in-built mechanism to limit the maximum spot price through the CPT) and regulatory developments since the commencement of the NEM are also placing downward pressure on wholesale spot prices.
- 3.7 The EOM market design presents challenges to participants and regulators as scarcity rent is in a delicate balance between revenue adequacy and intermittent market power.¹
- 3.8 Significant volumes of intermittent renewable generation were not contemplated at the NEM design stage. Intermittent renewable generation does not rely solely on the “spot market”, but receives a revenue stream from RECs in addition to its energy revenue.

¹ Henney and Bidwell, “Will NETA ensure generator adequacy?”, Power UK, Issue 122, April 2004.

- 3.9 In general, the economics of low-CO₂ emitting technologies such as wind, geothermal and nuclear mean that the cost structures for these technologies, as well as their operating regimes, do not rest well with the EOM. As the proportion of intermittent generation increases, the EOM design stresses the remaining fossil plant revenue (lower capacity factor and lower average prices). However such plant is essential to firm up the intermittent plant and provide energy security.
- 3.10 Intermittent generation severely stresses the EOM design and market reviews are underway in other regions. The UK is well advanced in this regard with imminent plans to move away from an EOM and to introduce a capacity payment.
- Revenue adequacy and financing arrangements must be effectively addressed in a market re-design.²
- 3.11 The Australian NEM EOM was assessed as being sustainable³, but only if it is allowed to operate without interference. Unfortunately, the NEM EOM is not being left alone as evidenced by the emergence of numerous schemes such as the renewable energy target and a plethora of state based climate change policies that have emerged.. The signs are that this trend is likely to continue.
- 3.12 It is therefore absolutely imperative that the AEMC separately, and certainly prior to even contemplating any rule change seeking to even further erode generators ability to achieve revenue adequacy, conduct a holistic review of the entire NEM trading arrangements in the context of recent international experience.

4 Market prices and new entrants

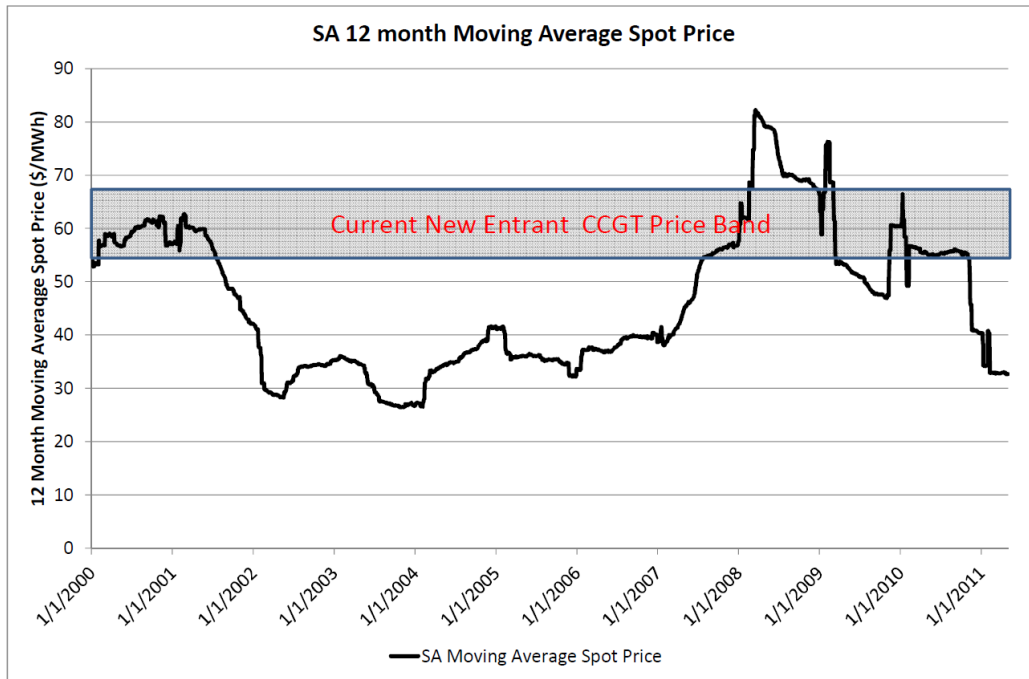
- 4.1 The NEM trading arrangement is designed to have low barriers to entry. By design, it is intended that potential attempts by incumbents to extract monopoly rents risks attracting new entry generation. This new entry can be either direct by an investor in generation in response to the forward price curve, or be sponsored by customers entering into long term bi-lateral contracts with a generator (or by installing their own generation).
- 4.2 The following chart shows the historical spot market prices in South Australia compared to current new entrant prices (in this case CCGT – combined cycle gas turbines (air cooled and 30 year life)).⁴

² Energy Market Assessment, Department of Energy and Climate change, March 2010.

http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/documents/digitalasset/dg.

³ AEMC/Reliability Panel, Comprehensive Reliability Review Report, CRAI modelling study.

⁴ AEMO ACIL-Tasman, Fuel resource, New Entry and Generation Costs in the NEM.



- 4.3 This chart shows that the spot prices in South Australia have been below the cost of a new entrant generator for most of the period shown. Even though prices did rise above the new entrant price band in 2008 and 2009, they rapidly returned to levels well below this range after the drought conditions driving the price changes subsided. The data shows that spot prices in South Australia have on average been below the current cost of a new entrant generator and therefore it has not been cost effective for a customer to sponsor a new entrant.
- 4.4 It thus appears that the MEU is seeking a rule change designed to distort the spot market outcomes in the near term to lower energy purchase costs. However such a rule change would serve to increase regulatory risks, distort the market dynamics, jeopardise new investments and ultimately serve to discourage investment. This in turn would result in sustained price increases to consumers.
- 4.5 Such an attempt to distort spot market outcomes also fails to recognise that end user electricity costs are not driven solely by the wholesale cost of energy in the spot or contract market. Prices also reflect other factors such as transmission and distribution network charges and charges imposed by State and Federal Government policies. This point is illustrated by the IPART announcement that the electricity prices the retailers can charge will increase on 1 July 2011 by an average of 18%. This price increase is being driven by a 6% increase from renewable schemes and a 10% increase in distribution and transmission network charges⁵.

5 Flaws in the MEU Rule Change Request

- 5.1 The MEU Rule Change Request is based on a number of fundamental fallacies and, if implemented as a Rule, would create significant distortions in the NEM and in the behaviour of market participants and be directly inconsistent with the NEO.

⁵ See IPART - "Changes in regulated electricity prices from 1 July 2011 Based on Draft Determination, April 2011

Further, although it purports to be addressing a perceived issue of market power in the wholesale market of the NEM, it would be fundamentally inconsistent with competition policy and the objectives of the CCA.

In particular, it takes no account at all of the principles of market definition or market power and fails to appreciate the basic principles of competition upon which Australian competition policy is based.

Its most basic flaw is that it takes no account at all of long-term considerations or assessments (whether in relation to market definition, market power or competition generally) or the significant and inevitable distortionary effects short-term regulatory intervention and manipulation will have upon matters essential to timely investment in response to market signals. If market signals are confusing, distorted, uncertain or unpredictable, efficient investment in generation or interconnection will not occur.

- 5.2 A matter of particular concern is that the MEU Rule Change Request ignores the concept that markets are dynamic and will evolve and expand over time. Introducing an arbitrary regulatory mechanism to constrain the behaviour of a “dominant generator” will severely curb the development of the wholesale market of the NEM.

Basically, the MEU Rule Change Request confuses, and as a result will merge, legitimate market conduct and behaviour (in accordance with the principles of workable and effective competition), with conduct that is distortionary in its own right (such as a dispatch offer or rebid that is not made in “good faith”). Regulatory oversight of specific behaviour that distorts the efficient operation of the NEM is already in place and must be distinguished from behaviour, even if opportunistic, that is expected in, and consistent with, workable competition.

- 5.3 The MEU Rule Change Request misunderstands or misstates fundamental principles of market power and the economic detriments to which a misuse of market power is properly directed.

The MEU Rule Change Request assumes that even if the 3 interrelated elements set out in section 46(1) of the CCA are not satisfied, a generator that is declared by the AER to be “dominant” should be constrained and prevented from offering a market-based price, and that other participants in the NEM should be entitled to a remedy. This misunderstanding is illustrated by the following extract from the MEU Proposal:⁶

*“The TPA has limitations in tackling the **outcomes** of the misuse of market power as it concentrates on ensuring there is strong competition as the fundamental approach to limit the outcomes of misuse. However, where there is market power and it is misused, but not for a purpose proscribed under the TPA, there is no legal remedy for that misuse. This means that there is no legal remedy for misuse of market power through strategically bidding to spike prices opportunistically to maximise revenue.”*

The flaws in this extract can be summarised as follows:

- (a) The MEU is seeking to establish a new definition of misuse of market power, inconsistent with established principles of competition policy and the operation and judicial interpretation of section 46 of the CCA. Basically, the MEU is seeking to change the law by way of a change to the Rules.
- (b) To suggest that a “limitation” in the operation of section 46 of the CCA or in “the outcomes of the misuse of market power” is that it concentrates on “ensuring there is strong competition” represents a fundamental misunderstanding of competition policy.

⁶ MEU Rule Change Request at pages 8-9.

- (c) It suggests that market power can be “misused” in circumstances other than one of the proscribed purposes set out in section 46(1)(c) of the CCA. This reference to “misuse” indicates an intentional or purposive act; not an objective effect of a use of market power. If the MEU is proposing an “effects-based” test for a use of market power, it must identify an anti-competitive effect analysed by reference to competition in a market and long-run considerations. In any event, as discussed in paragraph 3.5(b) of this Submission, an “effects-based” test has been rejected on a number of occasions and for good reason.
- (d) There are many circumstances in which a firm would engage in the same conduct (and would be able to engage in the same conduct) whether or not it had any market power. For example, it must be obvious that a generator could be in the position of facing residual demand in respect of a trading interval regardless of whether it has market power. In such an event, that generator will act in accordance with proper profit maximising principles, to take advantage of that situation as created by the market. It is plainly wrong to assume that a generator which faces a residual demand, whether in relation to any one trading interval or a number of trading intervals, has market power or, even if it did, would be engaging in conduct that it would not have engaged in if it did not have that market power.
- (e) For a generator to seek to “maximise revenue” in particular market conditions, does not mean that the generator has market power or that even if it does have market power, it has been used or “misused”. This has not been the view and position of the ACCC in the context of the NEM⁷. More particularly, it does not represent the objectives of competition policy.

5.4 The following extract from the MEU Rule Change Request reinforces the MEU’s misunderstanding of market power:⁸

“The fact that a generator may have market power is not the main issue. For much of the time a generator with market power is not able to exercise it. The problem arises when a generator which does have market power elects to exercise it because the conditions are favourable and profitable.”

By definition, a generator will not have market power unless it can behave persistently in a manner unconstrained by the conduct of competitors. Relevantly, it includes the power to raise prices above competitive levels in a sustainable way. Accordingly, the fact that a generator may take advantage of market conditions from time to time does not mean, of itself, that the generator has market power or that it is using market power.

Further, to suggest that in the context of the NEM “for much of the time a generator with market power is not able to exercise it” misconstrues an underlying concept of market power. Clearly, if a generator is constrained by much of the time, but on occasions can take advantage of favourable market conditions that is not an illustration of market power.

5.5 Other flaws in principle and analysis in the MEU Rule Change Request, both in relation to legal principles and the economic function in the context of the NEM, include the following:

- (a) The MEU assumes that its proposal for a “dominant generator” will identify a generator that has market power (according to both legal and economic principle). However, the definition proposed by the MEU for a “dominant generator” identifies ability at a particular time, or for a particular trading interval, without any regard to the question of whether that generator has a sustained and persistent ability or incentive to behave in a manner unconstrained by the relevant market.

⁷ Australian Competition and Consumer Commission - Final Determination - Applications for Authorisation - Amendments to the National Electricity Code - Changes to Bidding and Rebidding Rules - 4 December 2002.

⁸ MEU Request for change at page 22.

- (b) It is not accurate to describe section 46(1) of the CCA as being inadequate because “the generators’ actions are not motivated by an anti-competitive purpose”. In any event, the MEU is seeking introduction of a rule that is not directed towards anti-competitive purpose or anti-competitive effect. It is directed towards nothing more than the arbitrary imposition of a pricing constraint and a capacity direction upon a “dominant generator” if a particular event occurs (ie. the level of demand for a trading interval exceeds the level of demand to which the generator has been declared to be a “dominant generator”). In fact, according to the MEU Rule Change Request, no regard is to be given at all to any competition-based effects.

Even if one were able to discern any connection between the MEU Rule Change Request and any effect upon competition in the NEM, this would overlook the fact that a potential “effects-based” test under section 46 of the CCA has been examined and rejected on a number of occasions over many years.

One disadvantage of an “effects-based” test is that it does not distinguish between vigorous competitive activity by a firm (where such conduct has the ancillary effect of lessening competition) and conduct by a firm which prevents the competitive process from operating effectively with no offsetting efficiency benefits.

Schedule 1 to this Submission summarises the reviews of section 46 and the issue of whether it should incorporate an “effects-based” test. On each occasion, such a proposal has been rejected.

In particular, the Hilmer Report opposed an “effects-based” test for a use of market power under section 46:⁹

“A firm that succeeds in aggressive competitive conduct may drive other firms from the market and achieve a position of pre-eminence for an extended period. It does not necessarily follow, however, that the competitive process will be damaged by the conduct or that the potential for competition will be diminished, even if the immediate manifestations of the successful competitive conduct may suggest it. Firms should be encouraged to compete aggressively by taking advantage of new and superior products, greater efficiency and innovation. There is a serious risk of deterring such conduct by too broad a prohibition of unilateral conduct. The Committee takes the view that an effects test is too broad in this regard. The courts might develop a gloss upon an effects test to ensure that it did not prohibit economically efficient conduct, but it is not clear that the final result would differ from the existing interpretation of s.46, or that any such difference would constitute an improvement.”

- (c) The MEU states that a list of “dominant generators” to be evaluated and assessed by the AER each year is likely to change from year to year. This raises the following fundamental difficulties; namely:
- (i) It is implicit in this proposal that a generator identified as a “dominant generator” may well not have market power as its position in NEM from year to year is anticipated to change.
 - (ii) It fails to take account of principles of market definition.
 - (iii) It appears to assume that if, in any year, a generator is identified by reference to its ability to meet residual demand in a region for any trading interval, that will be sufficient for it to have market power and to be classified as a “dominant generator” for the whole of that year without any regard to market conditions, dynamics or circumstances.

⁹ Hilmer 1993,p. 70

By way of example, the AER has identified conduct of Delta Electricity in New South Wales in the period 2009-10 in rebidding capacity to higher prices to take advantage of a “tight market”.¹⁰

The cause of this “tight market” was congestion resulting from a delayed network upgrade in the New South Wales transmission network. It would be wrong to brand Delta Electricity as a “dominant generator”, or by such a classification deny it the opportunity to engage in conduct consistent with workable competition, by reason of an event affecting market conditions which was not caused by Delta Electricity and, if the upgrades have been completed on time, would never have presented any opportunity at all.

- (d) The MEU Rule Change Request proposes to invoke an *ex-ante* approach¹¹ and makes the following observation:¹²

“An ex-ante approach is designed to limit the ability of a dominant generator from offering prices outside a competitively based operating envelop[e]. This is best suited where there is a transparent spot market based on generator offers that can be related to their costs. The ex-ante approach would only need to apply at times where the dominant generator has the ability to exercise market power. Because for the most part, all generators are constrained by competition, it is relatively straightforward to develop a normal operating envelop[e] for price and output for a dominant generator.”

As an initial observation, there is an inherent uncertainty and unworkability in the expressions “a competitively based operating envelope” and “a normal operating envelope”. What is meant by them and who would define them or set their parameters?

In any event, in itself, this extract provides a further illustration of a lack of understanding of market power and the identification of a firm that possesses and uses market power. As discussed in section 8 of this Submission, if “for the most part, all generators are constrained by competition”, as acknowledged by the MEU, the basis for the MEU to assert any need for the MEU Rule Change Request is undermined.

Further, in 2009 Ofgem identified initial policy proposals for addressing market power concerns in the electricity wholesale sector¹³. It identified the following difficulties with an *ex-ante* approach:

“... A potential downside of the ex-ante approach is that ... it may not be sufficiently flexible to deal with all issues that could arise in the market. Furthermore, in the US the combination of automated bid price mitigation in constrained zones together with the application of relatively low price caps in the wider energy market has led many observers to comment on the “missing money” problem; prices may not rise sufficiently to attract new investment when and where it is required. In many US regions, further interventions, in the form of administered capacity payment mechanisms or must-run contracts for constrained plant, have been implemented to correct the “missing money” problem in the energy market. It may also be seen as overly “interventionist” by the standards of the GB market and hence could send a negative signal to investors. Moreover, ex-ante mitigation measures in the US regional markets are supplemented by federal market behaviour rules and anti-manipulation legislation. Finally, whilst an ex-ante approach would be relatively straightforward to administer once in place, it could incur considerable up-front implementation costs (e.g. in terms of system costs and changes to industry codes

¹⁰ Australian Energy Regulator - State of the Energy Market 2010 at page 34.

¹¹ MEU Rule Change Request at pages 30-31 and Appendix 1.

¹² Ibid at page 30.

¹³ Ofgem - Addressing Market Power Concerns in the Electricity Wholesale Sector - Initial Policy Proposals, 30 March 2009 at pages 31-32.

and settlement processes particularly within the Balancing and Settlement Code (BSC)).”

- (e) The MEU Rule Change Request, if implemented, would impose a requirement for consequential regulation, estimation and evaluation which would further distort and suffocate the evolution and development of the NEM. In particular:
- (i) the identification of a region of the NEM as if it were a separate market, without even taking into account the effects of interconnectors;
 - (ii) the identification of a “dominant” generator;
 - (iii) the question of whether a “dominant generator” in any one year will continue to be so declared by the AER in the following year, taking into account the effects of the regulatory restraint upon that “dominant generator” together with the fact that other generators may well take advantage of that regulatory restraint and be at risk of being declared as “dominant generators” in the following year;
 - (iv) the implications of forcing a “dominant generator” to dispatch, or offer for dispatch, all of its available capacity at the “dominant generator price cap”;
 - (v) determining whether the “dominant generator” has offered all of its available capacity to the market and how that is to be identified and measured;
 - (vi) the proposal that if the AER considers that a “dominant generator” has not offered all of its capacity to the market, “then the AER will recover the windfall profit from the dominant generator which will also be fined as well”;
 - (vii) the MEU Rule Change Request identifies “potential areas for derogations”, apparently in recognition of a need to provide for exceptions and exclusions from time to time.
- (f) The MEU Rule Change Request suggests, incorrectly, that in an evaluation of a request for a Rule Change, the AEMC is required to undertake a form of “net public benefit” test so that “it is necessary to identify if there is a net benefit from making such a change, such as the ACCC did in its recent decision preventing the NSW government from implementing its proposed co-insurance scheme in the sale of gentraders”.¹⁴

However:

- (i) Part 7 of the NEL does not prescribe a “net public benefit” test;
- (ii) the MEU is confusing the statutory test applicable to an application for an authorisation under Division 1 of Part VII of the CCA with the statutory process under Part 7 of the NEL; and
- (iii) even if the test, by analogy with Division 1 of Part VII of the CCA, is to be applied, the nature of that test is a “future with-and-without” test under which a pragmatic likely counterfactual must be identified and the future with the MEU Rule Change Request is evaluated as against the future without the MEU Rule Change Request.

¹⁴ MEU Rule Change Request at page 21.

6 The National Electricity Objective

6.1 Section 7 of the NEL sets out the NEO and provides as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to-

- (a) price, quality, safety, reliability and security of supply of electricity; and*
- (b) the reliability, safety and security of the national electricity system.”*

Although section 7 does not make any reference to competition, it may be inferred that the NEO is directed towards long term effective competition for the long term interests of consumers of electricity. In this regard an analogy can be drawn with section 44AA of the CCA (relating to third party access) which provides as follows:

“The objects of this Part are to:

- (a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and*
- (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.”*

This statutory recognition that economically efficient investment promotes long term effective competition is also an implicit element of the NEO. However, the MEU Rule Change Request is in direct contrast to both established principles.

6.2 The NEO is an essential pre-requisite for the purposes of any proposed Rule change:

- (a) section 32 of the NEL provides that in performing or exercising any function or power under the NEL, the Regulations or the Rules, the AEMC must have regard to the NEO; and
- (b) section 88(1) of the NEL provides that the AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the NEO.

6.3 Key elements of the definition of the NEO are as follows:

- (a) the promotion of “*efficient investment*”; and
- (b) recognition of the “*long term interests of consumers of electricity*” (emphasis added).

6.4 Any regulatory short term manipulation of a market (such as that proposed under the MEU Rule Change Request) that arbitrarily (or according to criteria irrelevant to competition policy) labels a generator as a “dominant generator”, and constrains the pricing activities of that “dominant generator” and directs available capacity to be offered in all and any trading intervals in which regional demand exceeds the level of demand at which that generator has been declared to be a “dominant generator”, must damage severely “efficient investment”. The lifeblood of any market is the reliability of market signals to encourage new entry or expanded capacity in a timely manner. The most obvious market signal to encourage and promote that “efficient investment” is pricing signals. This is an inherent part of effective or workable competition, and a fundamental element of the design of the NEM.

6.5 Similarly, the undeniable fact is that short term regulatory manipulation in relation to price can be adverse to the “long term interests of consumers of electricity” because it will deter

investment and lessen competition. This is a point that has been made by the Australian Competition Tribunal:¹⁵

“For example, action that promotes competition in the short-term may deter investment and hence, over the longer-term, competition may lessen (resulting in reduction to efficiency and innovation). ... Assessed over the long-term, however, there is less likely to be any conflict between the promotion of competition and efficiency.”

- 6.6 Consistent with the legitimacy of making long-term assessments, the NEO recognises that the most important issue is the long-term benefits to consumers of electricity. This will depend upon the relevant market (in this case the wholesale market of the NEM) having the incentive to invest in the “future market”. In simple terms, the distinction has been described as follows¹⁶:

“A short-run competitive equilibrium is (short-run) efficient; it makes the best use of presently available productive resources. A long-run competitive equilibrium guarantees that the right investments in productive capacity have been made but require that the three short-run conditions be met and adds two new ones. Production costs must not possess the conditions for a natural monopoly ... and competitors must be able to enter the market freely. With free entry, if there are above-normal profits to be made, new suppliers will enter which will reduce the level of profits. In this way free entry ensures that profits will not be above normal. A normal profit level is the key characteristic of a long-run competitive equilibrium.”

- 6.7 The MEU Rule Change Request, if implemented as a Rule, would have the effect of constraining the level at which a “dominant generator” can make dispatch offers or rebids in any trading interval in which regional demand exceeds the level of demand at which that generator has been declared by the AER to be a “dominant generator”. This monetary constraint may act as a penalty imposed on that “dominant generator”. In substance and legislative purpose and object (if not in form), the imposition of such a penalty is inconsistent with section 36(b) of the NEL. In addition, the imposition of such a monetary penalty would not fall within item 7 of Schedule 1 to the NEL. To constrain the maximum price at which a generator can make a dispatch offer or rebid is different from “the setting of prices for electricity and services purchased through the wholesale exchange operated and administered by AEMO, including maximum and minimum prices”. The imposition of such a monetary penalty would not be the imposition of an obligation for the purposes of section 34(3)(d) of the NEL.
- 6.8 The MEU Rule Change Request, if implemented, will mean that various generators from time to time may be declared as “dominant generators”. This will mean that if any “dominant generator” faces residual demand in a region for any trading interval, it will be constrained to a maximum dispatch offer or rebid equal to the Administered Price Cap and will be required to offer the whole of its available capacity into the market.

In itself, this introduces into the NEM a distortionary feature. Other generators will know who the “dominant generators” are and, as a result, know the nature of the constraint imposed upon them.

It must follow that implementation of the MEU Rule Change Request is likely to create further strategic behaviour by generators and retailers by reference to the constraints imposed upon the “dominant generators”. That is, the MEU Rule Change Request, if implemented, would exacerbate distortions, reduce efficiency by likely encouraging more strategic bidding and create unreliable and confusing market signals which will deter new investment.

¹⁵ *Seven Networks Limited (No. 4)* (2005) ATPR¶ 42-056 at [122].

¹⁶ Power System Economics, Steven Stoft at page 53.

A further inevitable consequence would be an adverse effect upon “safety, reliability and security of supply of electricity” and “the reliability, safety and security of the national electricity system”, contrary to the NEO.

The MEU recognises this issue (although it refers to it incorrectly as “tacit/parallel collusion”),¹⁷ but dismisses its significance by the following statement:¹⁸

“It is accepted that tacit and parallel collusion can occur, but unless the regulator has evidence that the second dominant generator in a region has both the opportunity and desire to use its market power, then it is preferable that the potential detriment of tacit and parallel collusion to be ignored unless the AER identifies it to be a problem.”

The inherent problems with this statement (including inconsistencies) are self-evident.

- 6.9 Section 34(1) of the NEL provides that the AEMC may make the Rules “in accordance with this Law...”. Clearly, the AEMC has no power to make a Rule that is not in accordance with the NEO. The MEU Rule Change Request is not consistent with the NEO and should be rejected outright on that ground alone.

7 The object of competition policy

- 7.1 The AEMC Consultation Paper glosses over clause 3.1.4(b) of the Rules which provides as follows:

“This Chapter is not intended to regulate anti-competitive behaviour by Market Participants which, as in all other markets, is subject to the relevant provisions of the Trade Practices Act, 1974 and the Competition Codes of participating jurisdictions.”

It is *the* stated purpose and object of the MEU Rule Change Request to implement a Rule change which is intended to regulate behaviour which the MEU has branded as “anti-competitive”.

The AEMC cannot ignore clause 3.1.4(b) of the Rules and cannot implement a Rule change that is inconsistent with clause 3.1.4(b). Section 91B(1) of the NEL provides that the AEMC may, “having regard to a request to make a Rule under section 91(1), make a Rule that is necessary or consequential to the Rule that is to be made on that request”. However, for the AEMC to make a decision that it now intends to perform (or to confer powers on the AER to perform) functions in relation to “anti-competitive behaviour by Market Participants”, is not necessary or consequential to the MEU Rule Change Request. It would be a complete reversal and restatement of the objects and purpose of Chapter 3 of the Rules.

Further, for the AEMC to make a Rule that is inconsistent with clause 3.1.4(b) of the Rules is not contemplated by the NEL. If the AEMC wishes to confer upon itself, the AER, AEMO or a jurisdictional regulator, functions or powers in relation to competition issues, the AEMC would be required by the NEL to conduct a review of the operation and effectiveness of the Rules under section 45(1) of the NEL and, at the completion of that review, give a copy of its report to the Ministerial Council on Energy.

- 7.2 Section 2 of the CCA states the object of the CCA to be “to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection”.

¹⁷ MEU Rule Change Request at page 43.

¹⁸ Ibid at page 44.

In the context of section 46 of the CCA, this object has been explained as follows:¹⁹

“The Parliament has determined that it is in the interests of consumers that firms be required to compete because competition results in lower prices, better goods and services and increased efficiency. The object of s46 - the protection of consumer interests - is to be achieved through the promotion of competition, even though competition by its nature is deliberate and ruthless and competitors injure each other by seeking to take sales from one another. A rational business firm seeks to maximise profit and to increase its share of a market. However, the very nature of such conduct is detrimental to other competitors in the market and may cause some of those competitors to leave the market.

...

When a court applies the provisions of s46 it must do so with the legislative object of the section in mind. While conduct must be examined by its effect on the competitive process, it is the flow-on result that is the key - the effect on consumers, not the effect on other competitors. Competition policy suggests that it is only when consumers will suffer as a result of the practices of a business firm that s46 is likely to require courts to intervene and deal with the conduct of that firm.”

- 7.3 This reference to competition policy and the object of the CCA (in the context of section 46) relates back directly to the two key components of the NEO; namely:
- (a) the promotion of efficient investment; and
 - (b) the long term interests of consumers of electricity.
- 7.4 There is absolutely no foundation for the AEMC to make a Rule change that is inconsistent with the objects of competition policy. The fundamental confusion in the MEU Rule Change Request relates to:
- (a) the misunderstanding on the part of the MEU that “the TPA focuses on whether conduct damages competitors, not on the effect of the actual exercise of market power to extract monopoly revenues from consumers and users”,²⁰
 - (b) conduct of a generator and effects upon competition in a market;
 - (c) short term and long term effects upon consumers of electricity;
 - (d) the basic principle that it is rational for a firm to maximise profit and increase market share; and
 - (e) even if a firm possesses market power (which must not be assumed by reason of some arbitrary criterion at a particular time) and the proscribed purpose test is not applied, it does not follow that:
 - (i) market power is being used (or misused); or
 - (ii) there is any effect, or likely effect, upon competition in the relevant market (assessed on a long term basis).

¹⁹ *Boral Besser Masonry Limited v Australian Competition and Consumer Commission* (2003) ATPR ¶ 41-915 at [260] and [261].

²⁰ MEU Rule Change Request at page 14.

8 The concept of competition

- 8.1 The MEU Rule Change Request does not refer to, and takes no account of, the most basic of competition principles; namely, the concept of competition and how competition is to be assessed for the purposes of competition policy.

It is established that the concept of competition is not “perfect competition”; rather, it is the practical economic concept of “workable competition” or “effective competition”. Competition must be assessed on a long term basis as it is acknowledged that short term assessments are distortionary.

Competition is a process and any effect upon competition is not to be equated with the effect upon competitors, although the latter may be relevant to the former. Clearly, competition in a market is not assessed by a “snapshot view” of particular behaviour at a particular time.²¹

In assessing “competition”, and in applying long term concepts, the combination of new entry or increased participation of existing participants in response to market signals and the continuing threat of new entry or increased participation, represents a significant constraint upon the behaviour of incumbents in a market. Basically, a market should be considered to have workable competition where new investment occurs in a timely manner in response to market signals.²²

- 8.2 The concept of “workable competition” was adopted by the Full Court of the Supreme Court of Western Australia in *Ex parte Epic Energy (WA) Nominees Pty Ltd*²³. In that case, the Full Court described “workable competition” as follows:

“... a workably competitive market will react over time and according to the nature and degree of various forces that are happening within the market. There may well be a degree of tolerance of changing pressures or unusual circumstances before there is a market reaction. The expert evidence and writings tendered in evidence suggest that a workably competitive market may well tolerate a degree of market power, even over a prolonged period. The underlying theory and expectation of economists, however, is that with workable competition market forces will increase efficiency beyond that which could be achieved in a non-competitive market, although not necessarily achieving theoretically ideal efficiency.”

- 8.3 These observations are consistent with the observations made by Network Economics Consulting Group Pty Ltd²⁴ in the early phase of the NEM, but which have continuing relevance:

“In assessing whether a market is functioning competitively, economists consequently do not focus on short-term incidents of market power, but rather look to see whether these processes of ongoing rivalry are playing themselves out over time. In a workably competitive market setting, suppliers are unable to influence prices over a sustained period, without being undercut by other incumbent generators or new entrants. In contrast, if there is no effective competition, suppliers may have sufficient market power to keep prices higher than they would otherwise be, through strategic behaviour. The key phrase in this context is ‘over a sustained period’. Market power becomes an issue of competition policy concern when producers have effective discretion as to when and how they exercise the market power they hold.

²¹ *Australian Gaslight Company v Australian Competition and Consumer Commission (No. 3)* (2003) ATPR ¶ 41-966.

²² See, for example, *Re Queensland Co-operative Milling Association Ltd* (1976) 25 FLR 169.

²³ [2002] WASCA 231.

²⁴ Network Economics Consulting Group Pty Ltd: *Where is Market Power Being Abused in the National Electricity Market - Some Economic Issues - A Critique of the ACCC Draft Determination in Relation to Proposed Changes to the Bidding and Rebidding Rules that Operate in the National Electricity Market*, September 2002 at pages 29-30.

It is well recognised that, in a workably competitive market, some (or even all) firms may have some degree of transitory market power but no firm has a substantial degree of market power.”

- 8.4 The Australian Competition Tribunal has observed recently that in considering the meaning of competition it is necessary to draw a distinction between, on the one hand, the *process* of competition and, on the other, the *extent* of competition, which is the outcome of that process.²⁵ The Tribunal stated that “competition may be described as rivalry that amounts to a process that leads to an increase in economic efficiency”.²⁶ As to the extent of competition, the Tribunal applied the observations of the Tribunal in *Application by Chime Communications Pty Ltd (No 2)* as follows:²⁷

“In the Tribunal’s view a market is sufficiently competitive if the market experiences at least a reasonable degree of rivalry between firms each of which suffers some constraint in their use of market power from competitors (actual and potential) and from customers. The criteria for such competition are structural (a sufficient number of sellers, few inhibitions on entry and expansion), conduct-based (eg no collusion between firms, no exclusionary or predatory tactics) and performance-based (eg firms should be efficient, prices should reflect costs and be responsive to change in market forces).”

- 8.5 This description of “workable competition” or “effective competition” demonstrates the complete economic fallacy in the MEU Rule Change Request. The MEU Rule Change Request:
- (a) fails to recognise that “workable competition” tolerates a degree of market power on the basis that market forces will increase efficiency on a longer term basis²⁸; and
 - (b) assumes that the NEM is not a market which displays the characteristics of “workable competition” or “effective competition” and has not been characterised by timely new entry or new investment (which is incorrect, as discussed in Section 11 of this Submission).

9 Market Definition

- 9.1 The MEU Rule Change Request fails to appreciate the significance of market definition and the fundamental “first step” of identifying a relevant market for the purposes of any competition assessment (including, of course, market power).

The MEU Rule Change Request appears to assume that the AER will identify a “region” and assume that such a “region” is a market for the purposes of competition policy.

Plainly, this represents a further fundamental error in the MEU Rule Change Request.

- 9.2 The approach to market definition has been the subject of considerable analysis in Australia. The Australian Competition Tribunal provided the following description of a market, for the purposes of the CCA, in its decision in *Qantas Airways*:²⁹

“A market is thus the smallest area of product, functional and geographic space within which firms could collectively possess substantial market power, that is the power to raise price above their opportunity costs by restricting output, or otherwise to act in a manner

²⁵ *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2 at [1049].

²⁶ *Ibid* at [1050].

²⁷ [2009] ACompT 2 at [48].

²⁸ For example, the MEU Rule Change Request suggests incorrectly that “when there is competition, the dominant generator in a region is effectively constrained to offer its energy at its short run marginal cost (SRMC) or risk not being dispatched” (at page 62).

²⁹ (2005) ATPR ¶42-065

unconstrained by competitors (ie no or little substitution in consumption or production), for a sustained period of time."³⁰

It is necessary to identify the sources of *actual* and *potential* competition, whose existence could significantly restrain an entity's power.³¹

9.3 In *Re QCMA and Defiance Holdings*³² the Tribunal (as it then was) stated that:

"[A] market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive".

9.4 The Tribunal more recently has described the output of the process of defining the relevant market as follows:³³

"The output of the process of defining the relevant market - the identification of the participating firms, a description of the products exchanged and the borders within which the exchange occurs - is critical to an assessment of the behaviour of firms in the market (ie whether or not they impose competitive constraints upon one another) and, importantly, whether or not a firm has, or a group of firms have, power to control prices or reduce competition (ie to shift the price away from that which would be obtained in a competitive market, namely the marginal cost of the product)."

9.5 It is well established that "close substitutability" is required in order for competitive activity to fall within one market.³⁴ The concept of interchangeability and close substitutability must be assessed by reference to long run considerations. Although the SSNIP test (small but significant non-transitory increase in price) is applied for the purposes of market definition, the following observation must be kept in mind:³⁵

"We do not treat the SSNIP test as being irrelevant to the question of market identification. However a qualitative application of the test requires identification of its purpose. As we understand it, the test looks to the actual or likely effect of competitive conduct, or potential competitive conduct, upon price and other conditions of supply, including quality of the product. However, competitive conduct may not have an immediate and obvious effect upon those matters. ... The 'richness' of the concept of competition ... means that competition may take many forms. Its effects may be immediate or delayed. The SSNIP test addresses the effects of competition, but it does not define the way in which it occurs."

9.6 As discussed by the Tribunal in *Re AGL Cooper Basin Natural Gas Supply Arrangements*,³⁶ an assessment of the temporal dimension of a market involves longrun considerations and the

³⁰ *Qantas Airways*, at [232].

³¹ *Qantas Airways*, at [237].

³² (1976) ATPR ¶ 40-102. This passage was quoted with approval and applied by the ACCC in its Public Competition Assessment of the swap of South Australian generation assets between AGL Energy Limited and TRUenergy Pty Ltd: Public Competition Assessment: *AGL Energy Limited and TRUenergy Pty Ltd - Proposed Swap of South Australian Electricity Generation Assets* (20 April 2007) at [24].

³³ *In the Matter of Fortescue Metals Group Limited* [2010] ACompT 2 at [1014].

³⁴ *Arnotts Limited v Trade Practices Commission* (1990) ATPR ¶ 41-061 at 51,785. As McHugh J observed in *Boral Besser Masonry Limited v Commission* (2003) ATPR ¶ 41-915 at [252]: "Close substitutability and competition are evident when more than a few consumers switch from one product to another on some occasions." The concept of substitutability for the purposes of market definition requires *close* substitution by reference to the degree of cross-elasticity of demand and cross-elasticity of supply: *Australian Rugby Union Ltd v Hospitality Group Pty Ltd* (2000) 173 ALR 702 at [83]; *Seven Network v News Limited* (2009) ATPR ¶ 42-301 at [619].

³⁵ *Seven Network Limited v News Limited* (2009) ATPR ¶ 42-301 at [670].

³⁶ (1997) ATPR ¶ 41-593 at 44,210.

concept of “operational time”.³⁷ In *Qantas Airways Limited*, the Tribunal stated that its long run rather than short run substitution possibilities that are relevant³⁸.

The wholesale market of the NEM

- 9.7 In *Australian Gas Light Company v Australian Competition and Consumer Commission (No. 3)*,³⁹ French J defined the wholesale market as one NEM-wide geographic market for the wholesale supply of electricity, and associated with that, entry into electricity derivative contracts.⁴⁰

French J observed that the NEM “is an evolving market which is intended and designed to operate as a single market for electricity throughout the regions which it covers”.⁴¹ Any “transient price separations” between regions are sub-markets only. A sub-market is not a “market” for the purposes of the CCA and can be “misleading if used uncritically to assess long-run competitive effects”.⁴²

- 9.8 The ACCC has not adopted the formulation of French J. However, even the ACCC has recognised the interrelationship between the regions of the NEM:
- (a) In undertaking its assessment of the acquisition by China Light and Power of the Australian non-regulated energy assets of Singapore Power (14 April 2005), the ACCC identified the relevant wholesale market within which its assessment was made as follows:

In summary, the ACCC believes that a geographic market based on Victoria and SA combined, taking into account the ability of this region to ‘import’ electricity from other parts of the NEM subject to interconnector capacity constraints, is a more accurate representation of the geographic constraints imposed on the merged entity in the context of this acquisition compared to consideration of a NEM-wide market.”

- (b) In its Public Competition Assessment of the AGL Energy Limited and TRUenergy Pty Ltd swap of South Australian electricity generation assets,⁴³ the ACCC considered the relevant wholesale market for the purposes of that matter to be the market for the wholesale supply of electricity in South Australia, taking into account the South Australia - Victoria interconnectors.

The ACCC acknowledged that even if the wholesale market is considered by reference to a particular region of the NEM, the effect of interconnectors must be taken into account, noting that “the degree of competition depends significantly on the level of interconnection between regions” and that “when assessing the constraint provided by generators outside the SA region, it is useful to think of an interconnector as being a generator with a varying marginal cost”.⁴⁴

- (c) In its determination upon the applications for authorisation by Macquarie Generation, Delta Electricity and Eraring Energy in respect of the proposed co-insurance arrangements⁴⁵ (Co-insurance Determination), the ACCC considered the relevant wholesale market affected by the proposed co-insurance arrangements to be “the

³⁷ See *Telecom Corporation of NZ Ltd v Commerce Commission* (1991) 3NZBLC ¶99-239.

³⁸ (2005) ATPR ¶42-065 at [235].

³⁹ [2003] ATPR ¶ 41-966.

⁴⁰ *Ibid* at [380] and [387].

⁴¹ *Ibid* at [387].

⁴² *Queensland Co-operative Milling Association Ltd* (1976) 25 FLR 169 at 191.

⁴³ ACCC Public Competition Assessment, 20 April 2007 at [20] - [42].

⁴⁴ ACCC Public Competition Assessment, 20 April 2007 at [30].

⁴⁵ Final Determination, 20 May 2010 at page 25 [4.37].

wholesale market for the supply of electricity in the NSW NEM region and the supply of products to mitigate against the risk of unfunded difference payments”.

- (d) In its Public Competition Assessment of the New South Wales Energy Privatisation⁴⁶, the ACCC “considered the proposed transaction on the basis that the geographic scope of the relevant market was the New South Wales region plus Victorian and Queensland interconnectors”. The ACCC added “this recognises that although generators outside of New South Wales do compete, their ability to do so is limited by the capacity of the interconnectors.”

- 9.9 In assessing the substance of the ACCC analysis of wholesale market definition in the NEM, it is instructive to set out the following extract from the AER “State of the Energy Market 2010”:⁴⁷

“While the market determines a separate price for each region, the mainland regions typically operate as an ‘integrated’ market with price alignment for 60-80 per cent of the time. Price alignment occurred for about 67 per cent of the time in 2009-10, compared with 70 per cent in 2009-10 [should read 2010-11]. These estimates allow for minor price disparities caused by transmission losses that occur when transporting electricity over long distances.”☑

- 9.10 Clearly, the consistent position of the ACCC, although not going so far as to accept the formulation of French J in *AGL*, is that, but for interconnector constraints from time to time between the regions of the NEM, the geographic dimension of the wholesale market would be the whole of the NEM.

When this position is aligned with the approach of the Australian Competition Tribunal to recognise a “future market” concept (ie. a market that evolves and expands over time) and the above AER extract, it is clear the geographic dimension of the wholesale market of the NEM must be broader than a “region”.

- 9.11 It would be completely artificial and arbitrary for a Rule to determine a “dominant generator” by reference to a “region”. It is wrong to identify a market by reference to such a narrow and fixed dimension in any event; it is a fundamental failure to recognise the inevitability of a broader geographic dimension of the wholesale market of the NEM and the necessity to assess a market by reference to long run considerations (including the “future market” concept).

10 Market Power

- 10.1 The MEU Rule Change Request misunderstands two essential elements in relation to market power:

- (a) The fact that market power requires, as an integral element, an ability to act without constraint on a sustained basis over time.
- (b) The fact that there are many circumstances in which a firm would engage in the same conduct (and would be able to engage in the same conduct) whether or not it had any market power and that engaging in such conduct is neither evidence of market power nor any use of market power.

⁴⁶ ACCC Public Competition Assessment, *AGL Energy Limited and Origin Energy Limited - Proposed Acquisitions of Assets being sold as part of the New South Wales Energy Privatisation*, 17 March 2011 at pages 11 and 12.

⁴⁷ Australian Energy Regulator - *State of the Energy Market 2010* at page 28.

- 10.2 In *AGL*, French J referred to the concept of market power as explained by the Trade Practices Tribunal in *Re Queensland Co-operative Milling Association Ltd* as follows:⁴⁸

“...the antithesis of competition is undue market power, in the sense of the power to raise prices and exclude entry. That power may or may not be exercised. Rather, where there is significant market power the firm...is sufficiently free from market pressure to ‘administer’ its own product and selling volume at its own discretion.”

- 10.3 The concept of *sustained* and *persistent* behaviour or activity assessed on a long term basis has been applied consistently by the courts in Australia. In *Melway*, the majority of the High Court of Australia confirmed this approach by stating:⁴⁹

“As Dawson J explained, in Queensland Wire, market power means capacity to behave in a certain way (which might include setting prices, granting or refusing supply, arranging systems of distribution), persistently, free from the constraints of competition.”

In *Boral*, McHugh J coined the expression that market power “is not concerned with a one-second snapshot of economic activity”.⁵⁰ It was added:⁵¹

“[A firm] possess market power when it has the ability to sustain a pricing policy or the terms on which it supplies its product without regard to market forces of supply or demand.”

In *AGL*, French J adopted the long term concept of market power in the context of the NEM. He distinguished “inter-temporal market power” from “a long run phenomenon having regard to the possibilities of new entry through additional generation capacity and the upgrade of interconnections between regions”.⁵²

French J identified transient conduct as being reflected in the concept of “temporal sub-markets” and added:⁵³

“I might add that success at ‘gaming’ in the market during limited periods of high demand does not reflect market power even if it results in a high forward contract price.”

- 10.4 The concept of “transitory market power” was expressly rejected by French J in the *AGL* case. French J did not consider that conduct of Loy Yang A Power Station reflected the existence of market power even though it was “in a position opportunistically to respond to supply/demand imbalance in very short time intervals and if all the variables are in the right place, to affect both spot and forward contract prices”.⁵⁴

- 10.5 The rejection of a concept of “transitory market power” by French J is consistent with the approach adopted in all markets. In *Universal Music Australia Pty Ltd v Australian Competition and Consumer Commission*⁵⁵, the Full Federal Court also rejected the concept of “temporary monopoly power”. The Full Court concluded that “temporary monopolies may be recognised as illustrating the working of competition in [a] market”⁵⁶ but that “temporary monopoly power” was not “sufficient to sustain a finding that the power of each company in the market was large or weighty, considerable, solid or big” and observed:

⁴⁸ (1976) 25 FLR 169 at 188.

⁴⁹ 178 ALR at 269.

⁵⁰ 195 ALR at [293].

⁵¹ *Ibid* at [264].

⁵² [2003] FCA 1525 at [493].

⁵³ *Ibid* at [492].

⁵⁴ [2003] ATPR ¶ 41-966 at [456].

⁵⁵ (2003) 131 FCR 529.

⁵⁶ *Ibid* at 565 [156].

“It is not legitimate for a court to base a finding of substantial market power simply upon incidents of abuse of power in that market. Almost all participants in a market have a degree of power, which may on occasion be abused.”

- 10.6 The MEU Rule Change Request appears to assume that a generator which faces a residual demand in any trading interval (or a series of trading intervals) possesses market power. Such an assumption is contrary to the basic requirements for market power to be identified and measured; namely, an ability to behave consistently and persistently on a sustained basis free from the constraints of competition. The idea of identifying market power by reference to a particular event (or series of events) at a particular time has been rejected on the basis that market power “is not concerned with a one-second snapshot of economic activity”.
- 10.7 Further, the MEU Rule Change Request assumes that the cause of a generator facing residual demand in any trading interval (or a series of trading intervals) is irrelevant. The essence of market power is that a firm has the ability to sustain a pricing policy *without regard* to market forces of supply or demand. A response by a firm to a short term market event (unrelated to conduct or behaviour of that firm) provides no evidence of market power or any use of market power. Any firm would have the same response whether or not it has market power. It is wrong for the MEU to assert that “there are times when outages of other generation plant or interconnectors, allow the exercise of market power at regional demands lower than the normal operating conditions”.⁵⁷

11 The recognition by the ACCC of longer term assessments of market power in the context of the NEM

- 11.1 The ACCC has recognised and applied longer term concepts and principles in respect of the wholesale market of the NEM and matters requiring an assessment of market power.

Market power and section 50 of the CCA

- 11.2 In its Public Competition Assessment of the acquisition by China Light and Power of the non-regulated assets of Singapore Power (14 April 2005), which included Torrens Island Power Station, the ACCC formed the view that the acquisition “would potentially result in an increased ability to profitably manipulate the wholesale spot price to a significant extent at certain times”, but considered that various factors identified by it would lead to the conclusion that “there was unlikely to be sufficient evidence of a substantially lessening of competition in breach of section 50”.

It is obvious that the ACCC formed the view that workable competition contemplates short term behaviour (including opportunistic behaviour) on the basis that longer term influences and constraints will increase efficiencies.

- 11.3 In its Public Competition Assessment of the swap of South Australian generation assets between AGL Energy Limited and TRUenergy Pty Ltd (20 April 2007), the ACCC observed:⁵⁸

“However, the proposed acquisition would not have given AGL any extra ability to raise prices in the SA node above and beyond the ability held by the current owner of TIPS, TRUenergy. The ACCC considered that AGL would participate in the same competitive environment as TRUenergy, the previous owner of TIPS, and was therefore likely to face the same competitive constraint from other generators both in South Australia, and in other states via the interconnector. This competitive constraint was unlikely to change post-transaction.”

⁵⁷ MEU Rule Change Request at page 42.

⁵⁸ At paragraph 46.

The ACCC also acknowledged the distinction between short term and long term assessments:⁵⁹

“The ACCC also accepted that, in the short term, there was a possibility that the liquidity of hedge products referenced against the SA node may decrease as a result of this transaction. However, market inquiries ... indicated that it was unlikely that this transaction would lead to a material long term decrease in the availability of hedge products in South Australia.”

Regulation of bidding and rebidding strategies

- 11.4 Clause 3.8.22A of the Rules provides that a generator “must make a dispatch offer, dispatch bid or rebid in relation to available capacity and daily energy constraints in good faith”. This reference to “good faith” means that at the time of making the offer, bid or rebid, a generator “has a genuine intention to honour that offer, bid or rebid if the material conditions and circumstances upon which the offer, bid or rebid were based remain unchanged until the relevant dispatch interval”.

Clause 3.8.22A is in substantially identical terms to clause 3.8.22A of the National Electricity Code. In its Final Determination to Authorise Changes to the Bidding and Rebidding Rules,⁶⁰ the ACCC endorsed the “good faith” provision “because the design of the electricity market auction relies on information being submitted by generators that reflects their true intentions relating to bids and rebids”.⁶¹

The ACCC noted that the “good faith proposal is not a restriction on rebidding per se” and acknowledged that “rebidding is a key element of the market design because it allows the market to balance supply and demand efficiently to ensure demand is met by efficiently priced supply”.⁶² Significantly, the ACCC made the following observation:⁶³

“More importantly however, restrictions on the ability to rebid, or the imposition of incentives not to rebid, could lead to less efficient outcomes and potentially higher prices, as compliance costs are recouped through generator’s bids. Restrictions on rebidding could produce a wedge between actual and competitive price outcomes, leading to less efficiency and inefficient dispatch of generation. This is clearly not in the long-term interest of the market.”

- 11.5 An element of the Applications for Authorisation included a proposal by NECA to prohibit bids or rebids that have the purpose, or have or are likely to have the effect, of materially prejudicing the efficient, competitive or reliable operation of the NEM. This proposal was rejected by the ACCC. It being noted that “flexibility” must be built into any code change that prohibits such behaviour [in that case, economic withholding], to allow a reprieve for generators where there is a legitimate basis for such bids” and that “the potential anti-competitive detriment of deterring investment could well outweigh the public benefits of prohibiting economic withholding where it is undertaken to game market outcomes”.⁶⁴

The ACCC made the following observations that are pertinent in the context of the MEU Rule Change Request:⁶⁵

“Behaviour that deliberately exploits constraints effectively punishes the market for under-investment or lack of development. Price spikes identify investment opportunities in transmission or generation. Without these signals, the energy-only market would cease to work effectively. The fact that such constraints can be used indicates that constraints and

⁵⁹ Ibid at paragraph 64.

⁶⁰ ACCC - Determination - Applications for Authorisation - Amendments to the National Electricity Code - Changes to Bid and Rebidding Rules, 4 December 2002.

⁶¹ Ibid at page 18.

⁶² Ibid at page 20.

⁶³ Ibid.

⁶⁴ Ibid at page 29.

⁶⁵ Ibid at page 30.

congestion in transmission pricing in the NEM is being inadequately addressed. Investment opportunities may be more effectively signalled if there were more regions in NEM, or if nodal pricing was introduced. In their absence, pricing signals on the supply side should be maintained. Any muting of these signals will raise questions about the market's design and its ability to develop into the future."

11.6 The ACCC recognised that "due to the lead times involved in large scale investments like electricity transmission and generation, delays can arise between the time when prices begin to signal the need for new investment and the time when such investment is brought online and begins to moderate prices". Further, the ACCC accepted that "in practice it may be necessary to tolerate some short term price spikes in order to encourage efficient investments" and noted that "short term price spikes are common to deregulated electricity markets, and the Commission believes that focussing on price outcomes over a short period of time is irresponsible, as it can lead to biased conclusions".⁶⁶

11.7 In *AGL*,⁶⁷ French J referred to the ACCC Final Determination and, in respect of price spikes that had been observed in the summer of 2000/2001 in Victoria, concluded as follows:

"The particular conjugation of pressures from financiers and fortuitous events upon which Loy Yang Power relied in the summer of 2000/2001 does not allow an inference to be drawn from the successful application of the summer bidding strategy that it had then and continues to enjoy now, market power in terms of an ongoing ability to price consistently above its marginal costs of production."

11.8 Accordingly, it is clear that a distinction must be drawn between the following:

- (a) the right of any generator to make legitimate dispatch offers or rebids in the context of, or in response to, independent market conditions and circumstances from time to time; and
- (b) a generator making a dispatch offer or rebid otherwise than in "good faith".

In the context of paragraph (a), the occurrence of price spikes represents the response to market conditions prevailing at the relevant time and, as identified by the ACCC, is of central importance to "identifying investment opportunities in transmission or generation". The fact that there is a lead time involved between the recognition of a market signal encouraging new investment and the time when that new investment is commissioned, does not mean that a market is inefficient or is not representative of workable competition. Clearly, any regulatory manipulation of such a market (and behaviour in such a market) will cause dislocation and distortion in respect of new investment, including uncertainty created by such arbitrary regulatory information deterring or delaying new investment decisions.

The contention by the MEU that "competition cannot be easily improved where there is no instant freedom of entry and new generation plant cannot be quickly built and commissioned"⁶⁸ indicates a basic misunderstanding of workable or effective competition.

11.9 As discussed in section 3 of this Submission, an EOM market design requires both occasional price spikes and any resulting "situational market power" to be sustainable. This has been recognised and accepted by the Federal Court of Australia. It has been also recognised by the ACCC both in the context of its review of clause 3.8.22A as it appeared in the National Electricity Code and in decisions of the ACCC under its informal merger review process for the purposes of section 50 of the CCA.

⁶⁶ Ibid.

⁶⁷ (2003) ATPR ¶ 41-966 at [464] - [469].

⁶⁸ MEU Rule Change Request at page 14.

12 Regulatory Oversight

12.1 The MEU Rule Change Request takes no account of:

- (a) the extent and degree of regulatory oversight in the context of the NEM; or
- (b) the fact that the very issue that appears to be its central complaint (ie. the activities of Torrens Island Power Station in South Australia) has arisen pursuant to decisions of the ACCC under its informal merger review process for the purposes of section 50 of the CCA.

Regulatory constraint as countervailing power

12.2 It is clear that regulatory constraint is accepted as a form of countervailing power. The MEU Rule Change Request fails to recognise that the existing measures of regulatory oversight, or the threat of those measures being used against a generator, acts as a form of constraint and countervailing power.

12.3 In *AGL*, French J made the following observations:⁶⁹

“It is probably correct to say that in an economic sense there is not a high degree of countervailing consumer power which can be brought to bear upon the pricing practices of generators. There is however some scope for demand side management and perhaps of particular significance in the NEM is the reality that high electricity prices can very quickly become a political or regulatory issue. While countervailing power may not be exercised economically it can be exercised politically or by the regulator as proxy for consumers.”

12.4 This concept of regulatory oversight being a form of countervailing power has been applied elsewhere. For example, in *Verizon Communications Inc. v Law Offices of Curtis V Trinko, LLP*,⁷⁰ the Supreme Court of the United States made the following comment:

“One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny.”

12.5 Similarly in the decision by the Commerce Commission of New Zealand in the matter of an *Application for Clearance of a Business Acquisition involving Vector Limited and NGC Holdings Limited*,⁷¹ the Commerce Commission commented as follows:

*“Regulatory constraints form part of the competitive landscape, and must be taken into account when carrying out competition analysis. For example, in *Telecom Corporation of New Zealand Ltd v Commerce Commission*...the Court of Appeal considered that regulatory constraints, including current regulation and the threat of further regulation, were ‘part of the environment constraining Telecom in practical terms from engaging in discriminatory conduct’.”*

12.6 By way of example only of the extent and degree of regulatory oversight, reference can be made to each of the following:

- (a) The AER investigated compliance on the part of AGL Energy Limited with clause 3.8.22A of the Rules in respect of its rebidding conduct for Torrens Island Power Station on 19 February 2008. The AER concluded as follows:⁷²

⁶⁹ Ibid at [396].

⁷⁰ (2004) 540 US 398 at 412.

⁷¹ Commerce Commission of New Zealand, decision No. 540, 10 December 2004 at page 23 [126].

“Having regard to all of the relevant information and the evidence available relating to rebidding decisions, the AER has closed its investigation regarding AGL’s compliance with clause 3.8.22A during the February 2008 period.”

- (b) The AER issued proceedings in the Federal Court of Australia against Stanwell Corporation Limited for an alleged breach of clause 3.8.22A of the Rules. As the AER has noted:⁷³

“The AER alleged Stanwell did not make several of its offers to generate electricity on 22 and 23 February 2008 in ‘good faith’, contrary to clause 3.8.22A of the Electricity Rules. The AER sought orders that included declarations, civil penalties, a compliance program and costs.”

Judgment is pending in that case.

- (c) As summarised in paragraph 10.9 of this Submission, the ACCC has exercised its powers under section 155 of the CCA in respect of suspected conduct of AGL in relation to Torrens Island Power Station.
- (d) The MEU Rule Change Request refers to the role of Macquarie Generation. The structure of the wholesale market in relation to the New South Wales region was assessed and evaluated by the ACCC as part of the New South Wales Energy Privatisation for the purposes of section 50 of the CCA.

In its Public Competition Assessment,⁷⁴ the ACCC concluded:

- (i) that *“the aggregation of generation capacity arising from the proposed acquisitions by AGL or Origin of one of the gentrader contracts would not be likely to substantially lessen competition in the market for the wholesale supply of electricity in New South Wales”*;⁷⁵
- (ii) that *“the respective proposed acquisitions by AGL or Origin of Integral Energy or Country Energy were not likely to substantially lessen competition in the market for the retail supply of electricity in New South Wales due to likely continued competition from existing competitors, and a degree of potential competition from new entry”*;⁷⁶ and
- (iii) that *“the change in vertical integration within the New South Wales market as a result of the proposed acquisitions was not sufficient to result”* in a *“reduction in participation in hedging markets”* that *“might stifle the ability of existing competitors and potential new entrants to compete”*.⁷⁷

The point to emphasise is that the structure in the New South Wales region of the NEM was developed as part of the New South Wales Energy Privatisation process and was approved by the ACCC. The ACCC approved a proposed structure in which Macquarie Generation has been left intact on the basis that such a structure would not confer market power and, as a result, would not be likely to have the effect of substantially lessening competition. This conclusion was reached by the ACCC after it took into account its observation in relation to Macquarie Generation, that it *“will*

⁷² Australian Energy Regulator - Investigation Report - AGL’s Compliance with the Good Faith Rebidding Provision of the National Electricity Rules on 19 February 2008, May 2009 at page 16.

⁷³ Australian Energy Regulator State of the Energy Market 2010 at page 45.

⁷⁴ Australian Competition and Consumer Commission - Public Competition Assessment - AGL Energy Limited and Origin Energy Limited - proposed acquisitions of assets being sold as part of the New South Wales Energy Privatisation, 17 March 2011.

⁷⁵ Ibid at [107].

⁷⁶ Ibid at [80].

⁷⁷ Ibid at [117] and [118].

continue to be the largest generator in the region and therefore more likely to be in a position to be required to meet demand and materially influence the spot price than the other generators or gentraders.”⁷⁸

Regulatory approvals in connection with Torrens Island Power Station

- 12.7 It is an essential part of the background to recognise that ownership of Torrens Island Power Station (TIPS) by AGL Energy Limited was approved by the ACCC under its informal merger review process for the purposes of section 50 of the CCA.

Firstly, the ACCC approved of the acquisition of TIPS by China Light and Power. Secondly, it approved the swap of South Australian electricity generation assets as between AGL Energy Limited and TRUenergy Pty Ltd, which included transfer of ownership of TIPS to AGL Energy Limited.

- 12.8 The ACCC conducted economic analysis which suggested that during periods of high demand, TIPS had the ability to increase average South Australian pool prices, through strategic bidding, by at least 5%.

However, the ACCC concluded that this ability already existed when TIPS was owned by TRUenergy and no greater ability to raise prices would be conferred upon AGL. In addition, the ACCC concluded that AGL would likely be subject to the same competitive constraints which previously existed for TRUenergy.⁷⁹

- 12.9 Accordingly, it is wrong for the MEU Rule Change Request to infer that, whatever its view of the position in the South Australian region of the NEM may be, there is some market distortion or characteristic that must be addressed by the Rules (not only in relation to South Australia but across the whole of the NEM).

Existing statutory mechanisms are sufficient and it is obvious that the ACCC is approaching the matter by reference to relevant provisions of the CCA and there can be no suggestion that the ultimate outcome will be ineffective.

13 Market characteristics

- 13.1 It is of fundamental importance to recognise the clear distinction between market characteristics, trends and forces and strategic behaviour by a firm in a market.

The MEU Rule Change Request assumes that the observations of the MEU, particularly in relation to the South Australian region of the NEM, arise or are caused by strategic behaviour which must be constrained by arbitrary short term regulation.

- 13.2 There are various flaws in this assumption, including the dynamic nature of the NEM and the economic efficiencies that the introduction and operation of the NEM has produced.

For example, as depicted in Schedule 2 to this Submission, Australia has low electricity prices compared with most other OECD countries.⁸⁰

- 13.3 It is wrong for the MEU Rule Change Request to infer that price spikes in the NEM are very regular occurrences or are caused by strategic behaviour of generators. As ABARES also noted “occasional price spikes are often caused by factors such as widespread heatwaves,

⁷⁸ Ibid at [103].

⁷⁹ ACCC Public Competition Assessment - AGL Energy Limited and TRUenergy (20 April 2007) para 45, 46

⁸⁰ See generally ABARES - Energy in Australia 2011 at page 27.

industrial disputes or generator malfunctions” and in the case of Tasmania in June 2009, “mainly because of lower water inflows into hydroelectric plants”.⁸¹[OK]

As the graph in Schedule 3 to this Submission illustrates, price spikes in each region of the NEM occur largely by reference to extraneous events at similar times in each year. South Australia is a clear example with price spikes typically occurring on days of extreme weather leading to high electricity demand and tight regional supply-demand balance.⁸²

13.4 As the ACCC has acknowledged in the context of market signals and new investment in the NEM⁸³, relatively long lead times are involved. However, it has not been suggested that new investment has lagged unreasonably behind market signals or has been deterred or delayed by the behaviour of incumbents. This has been acknowledged by the AER recently which has noted the following:

- (a) *“Generation investment over the past decade generally kept pace with rising demand and provided a safety margin of capacity to maintain the reliability of the power system.”⁸⁴*
- (b) *“Recent AEMO assessments found installed and committed capacity (excluding wind) across the NEM as a whole will be sufficient until 2013-14 to meet peak demand projections and reliability requirements.”⁸⁵*
- (c) *“New investment in the NEM is largely driven by price signals in the wholesale and forward markets for electricity. From the inception of the NEM in 1999 to June 2010, new investment added around 12,100MW on registered generation capacity. ... Tightening supply conditions lead to an upswing in generation investment from around 2005.”⁸⁶*

Characteristics of the South Australian region

13.5 The MEU Rule Change Request suggests that in relation to the South Australian region of the NEM “new generation investment is not driven by the spot market price signals to the extent envisaged”. The example that purports to support this suggestion is that “in SA the market signals since 2007 (driven by the exercise of market power by TIPS) would indicate there is a major need for new generation investment yet the market itself has decided that these signals are basically spurious”.⁸⁷

13.6 The first points to emphasise are as follows:

- (a) There is no acceptance of the assertion that there is a “major need for new generation investment” in South Australia.
- (b) The prices in South Australia (inclusive of the occasional spikes) do not underpin investment in new generation. As discussed in section 4 of this Submission, spot prices in South Australia have been below new entrant prices.

The MEU contentions that “the market signals ... would indicate there is a major need for new generation” and that “these signals are basically spurious” are simply and demonstrably wrong.

⁸¹ Ibid.

⁸² Australian Energy Regulator - State of the Energy Market 2010 at page 30.

⁸³ See paragraph 9.6 of this Submission.

⁸⁴ Ibid at page 11.

⁸⁵ Ibid.

⁸⁶ Ibid at page 37.

⁸⁷ MEU Rule Change Request at page 24.

- 13.7 In addition to there being no price signal in South Australia to encourage new investment in generation, the market projections for South Australia are at risk from further penetration by other factors and influences.

Relevant market signals in a market that represents “workable competition” are not limited to pricing signals alone (whether by reference to the “spot market price” or by reference to forward contract prices). Markets can (and do) identify other signals that can be relevant to a new investment decision-making process.

Regional circumstances and conditions provide relevant market signals for the purposes of new investment and it is incorrect for the MEU to suggest that “spot market price signals” in the South Australian region are “basically spurious”. Characteristics of the South Australian region of the NEM must be also taken into account.

- 13.8 In essence, the MEU Rule Change Request is an example of the kind of regulatory intervention that would deter new investment regardless of price signals, and if implemented, would have an effect that would be exactly opposite to that which the MEU hopes to achieve.

- 13.9 The South Australian region of the NEM is subject to several characteristics that have, and will continue to have, a significant effect upon investment decisions and the timing of those investment decisions. Principal characteristics of this description are the following:

- (a) Low demand growth and continuing low demand growth projections in the South Australian region.
- (b) Surplus installed capacity.
- (c) Intermittent generation capacity (wind).
- (d) “Needle peak” demand characteristics.

Low Demand Growth Projections

- 13.10 It is a fact that the South Australian region has low demand growth projections. This is evidenced by the following data in the 2010 Electricity Statement of Opportunities for the NEM.

- 13.11 According to this data, at the 10% POE⁸⁸, medium growth scenario:

- (a) South Australia summer maximum demand is projected to increase from 2010/11 to 2019/20 by only 480MW or 1.4%.
- (b) South Australian winter maximum demand is projected to increase from 2010/11 to 2020 by only 400MW or 1.4%.
- (c) South Australian energy is forecast to increase from 2010/11 to 2019/20 by only 1205GWh or 0.9%.

Surplus installed capacity

- 13.12 The existing scheduled and semi-scheduled generation capacity relevant to the South Australian region can be summarised as follows:

- (a) Scheduled and semi-scheduled generation in the South Australian region as set out in the 2010 4120.3MW

⁸⁸ Percentage probability of exceedence. A POE for demand refers to the likelihood that a projection will be exceeded in any given year.

	Electricity Statement of Opportunities (including 480.3 MW of wind generation)	
(b)	Interconnection (Heywood 460MW and Murraylink 220MW)	680MW
	TOTAL	4800.3MW

The committed projects comprise 381MW of which 335MW is wind generation.

- 13.13 Accordingly, a current maximum summer demand of 3,530MW faces 4800.3MW of available generation capacity and interconnection.
- 13.14 Consistent with this data is the observation in the 2010 Electricity Statements of Opportunities that under medium economic growth, South Australia will not require new investment (beyond committed capacity) until 2015/16.

Similarly, in the Final Report in relation to the South Australian Interconnector Feasibility Study in February 2011,⁸⁹ key conclusions include the following:⁹⁰

“The feasibility study has demonstrated that there is potential for augmenting transmission capacity between South Australia and the rest of the NEM, not only to facilitate export of renewable energy out of South Australia, but also to support South Australian peak demand as the level of intermittent generation increases.”

“The incremental option to augment the existing Heywood interconnector was shown to be economically feasible as early as 2017/18 under high growth and carbon price conditions and with significant wind investment in South Australia (Green Grid sensitivity). ... However, if other market benefits are taken into account (e.g. competition benefits) the timing could be advanced.”

These conclusions recognise that there is a potential need for augmenting transmission capacity, subject to the scenarios considered and the assumptions made; but that economic feasibility of augmentation is not likely to occur before 2017-18.⁹¹

Intermittent generation - Wind

- 13.15 Wind farms have very limited flexibility regarding operation and output. The magnitude of the variability depends on several factors including weather and surface conditions.⁹²

It is an accepted fact that semi-scheduled generation capacity in South Australia has a significant impact upon the operation of scheduled generation plant in relation to that region.

- 13.16 In a report on interviews with participants in South Australia’s retail energy markets prepared for the Essential Services Commission of South Australia,⁹³ the effects of significant wind generation capacity in South Australia was summarised as follows:⁹⁴

“Substantial wind energy capacity - the high penetration of wind energy in South Australia is depressing spot prices and resulting in a high number of negative price events. Additionally,

⁸⁹ ElectraNet - AEMO Joint Feasibility Study - South Australian Interconnector Feasibility Study, February 2011.
⁹⁰ Ibid at page 11.
⁹¹ Under the other scenarios considered, economic feasibility may not occur until 2020 to 2025 or 2020 to 2030.
⁹² The Electricity Supply Industry Planning Council of South Australia (ESIPC) Report titled “Wind Report to ESCOSA” April 2005 at page 8.
⁹³ ACIL Tasman - Competition in South Australia’s Retail Energy Markets - Report on Interviews with Participants, 24 June 2010.
⁹⁴ Ibid at page viii.

the wind energy generators are displacing output from existing generators. To ensure the existing generators are able to earn a reasonable return, these generators have an incentive to reduce the level of contracting and bid spot prices up.”

Wind generation has a strong incentive to maximise the extent to which it is dispatched as its revenue for both energy and renewable energy certificates is dispatch-driven. As ACIL Tasman observed “when this second revenue stream is taken into account, it is rational for a wind energy generator to bid down to negative values to maximise profitable dispatch”.⁹⁵ ACIL Tasman continued:⁹⁶

“This approach to bidding has seen wind energy generators recently flood the market with energy. In 2008/09, wind provided 18 per cent of the electricity consumed in South Australia, up from two per cent in 2004/05 and zero per cent in 2001/02. The Electricity Supply Industry Planning Council expects the output of wind farms in South Australia to nearly triple from 2078GWh in 2008/09 to 6061GWh by 2012/13.”

“Needle-peak” demand

- 13.17 The “needle-peak” demand characteristic in the South Australian region is well known to the AEMC and is illustrated by the graph in Schedule 3 to this Submission. The extreme weather events including the heatwaves experienced in 2007/08 and 2008/09 and the drought before that time, have increased the impact of this characteristic and have been seen as a cause of high wholesale prices during periods of peak demand during that period.⁹⁷

⁹⁵ Ibid at page 33.

⁹⁶ Ibid.

⁹⁷ Ibid at pages viii and 31.

14 Glossary

For the purposes of this Submission:

ACCC means the Australian Competition & Consumer Commission.

AEMC means the Australian Energy Market Commission.

AEMO means the Australian Energy Market Operator.

AER means the Australian Energy Regulator.

CCA means the *Competition and Consumer Act 2010*.

CPT means Cumulative Price Threshold.

EOM means Energy Only Market.

IPART means the Independent Pricing and Regulatory Tribunal of New South Wales.

MEU means the Major Energy Users Inc.

MEU Rule Change Request means the Proposed Rule Change to Enhance Generator Competition Outcomes During High Demand Periods in the NEM submitted to the AEMC by the MEU, 15 November 2010.

NEL means the National Electricity Law.

NEM means the National Electricity Market.

NEO means the National Electricity Objective.

REC means Renewable Energy Certificate.

Rules means the National Electricity Rules.

SCHEDULE 1

Historical reviews of section 46 and an “effects-based” test (Dawson Committee Report)⁹⁸

- 1 In 1976, the Trade Practices Act Review Committee (the Swanson Committee) recommended that the section should only prohibit abuses by a monopolist that involve a proscribed purpose.
- 2 In 1979, the Trade Practices Consultative Committee (the Blunt Review) rejected an effects test because it would give the section too wide an application, bringing within its ambit much legitimate business conduct.
- 3 In 1989, the House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffiths Committee) concluded that there was insufficient evidence to justify the introduction of an effects test into section 46.
- 4 In 1991, the Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee) concluded that an effects test might unduly broaden the scope of conduct captured by section 46 and challenge the competitive process itself.

The Cooney Committee recommended that s46 be amended to emphasise that the policy objective of the section is the protection of the competitive process rather than individual competitors.

The Report concluded that it was appropriate for the distinction between purpose and consequence to be maintained (p 66).

Adding an ‘effects’ test to s 46 would “unduly widen the operation of the prohibition” and “force corporations to evaluate the potential effect of their every action on their competitors and potential competitors.” (p 66).

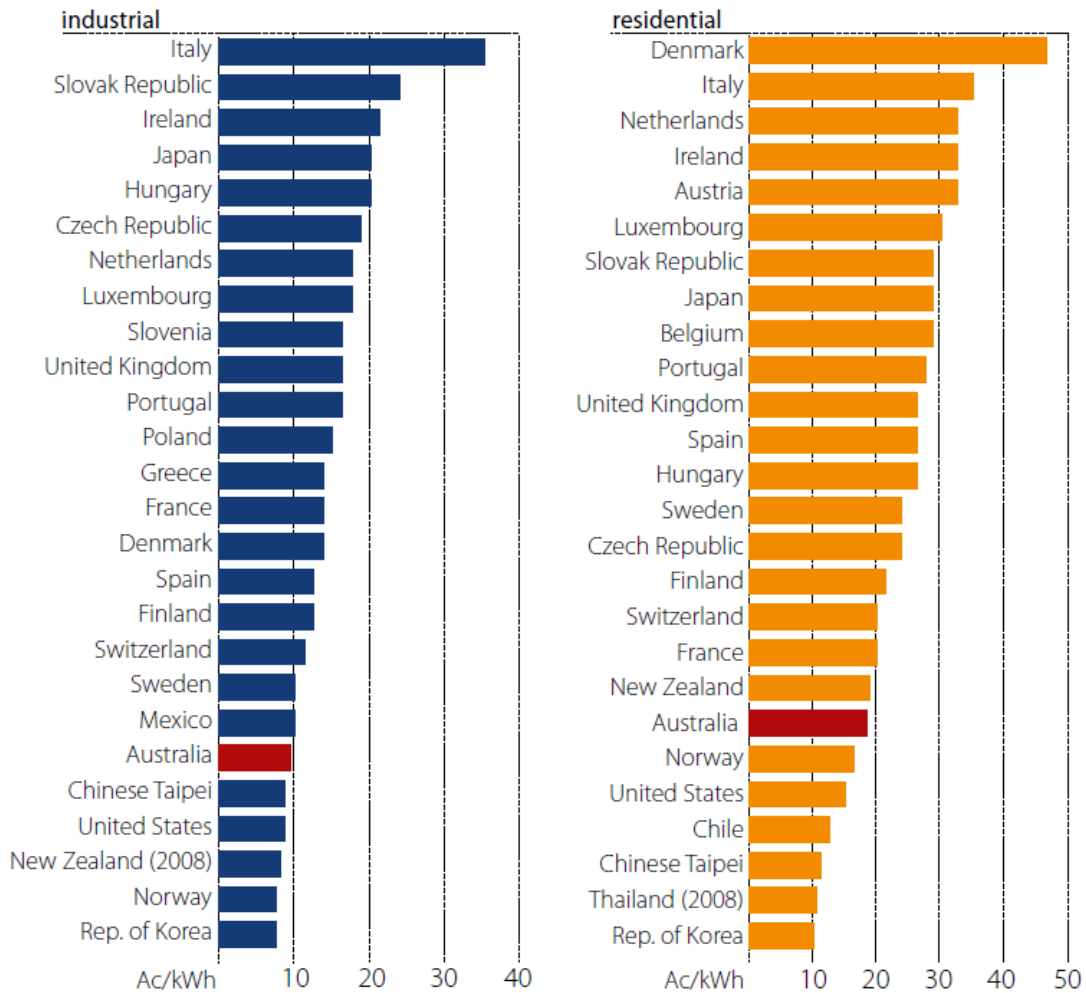
- 5 In 1993, the Independent Committee of Inquiry into Competition Policy in Australia (the Hilmer Committee) rejected an effects test because it would not adequately distinguish between socially detrimental and socially beneficial conduct.
- 6 In 1997, the House of Representatives Standing Committee on Industry, Science and Technology (the Reid Committee) noted the effects test and the views of the Hilmer Committee, but did not recommend its introduction.
- 7 In 1999, the Joint Select Committee on the Retailing Sector (the Baird Committee) rejected an effects test on the basis that such a far reaching change to the law may create much uncertainty in issues dealing with misuse of market power.

In 2001, the House of Representatives Standing Committee on Economics, Finance and Public Administration (the Hawker Committee) noted significant opposition to an effects test and that five inquiries since 1989 had not recommended its introduction.

⁹⁸ Dawson Committee Report, p 83 “Box 3.2: History of the effects test”

SCHEDULE 2

World electricity prices, selected countries, 2009 a

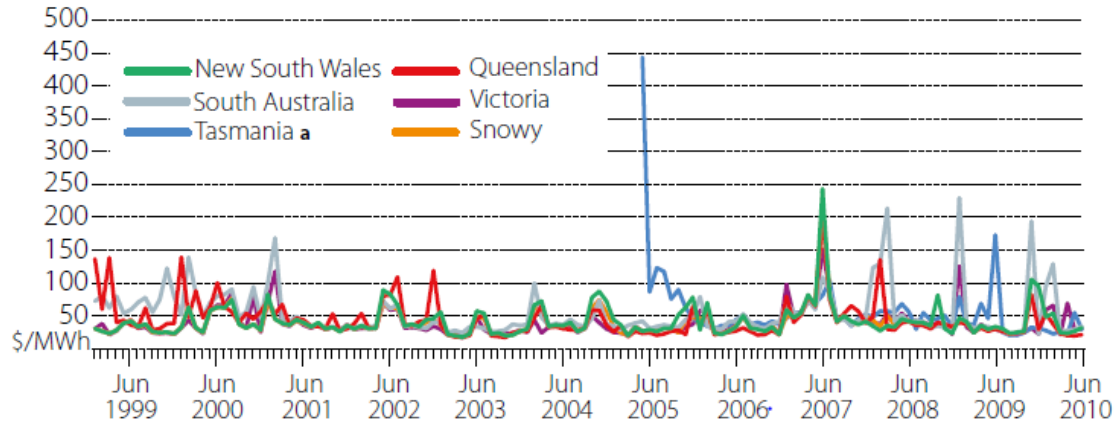


a Australian prices estimated using 2004 prices from IEA Energy Prices and Taxes, and ABS index of electricity prices for households and businesses.

Sources: IEA, *Energy Prices and Taxes 2010*; ABS.

SCHEDULE 3

Spot market prices in the National Electricity Market
average monthly wholesale, in 2009–10 dollars



a Tasmania joined the National Electricity Market in 2005.

Source: AEMO.