Mr. John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South, NSW 1235

Friday, 20 July 2012

Dear Mr. Pierce,

Submission – Draft Rule Determination on Potential Generator Market Power in the NEM (AEMC Reference ERC0123)

International Power-GDF Suez Australia (IPRA) appreciates the opportunity to comment on Draft Rule Determination on Potential Generator Market Power in the NEM.

About IPRA

International Power, now a wholly-owned subsidiary of GDF SUEZ, is a leading independent electricity generating company with 75,579MW gross (43,288MW net) in operation and a significant programme of 12,820MW gross (5,868MW net) projects under construction as at 31 December 2011. International Power is present in 30 countries across six regions worldwide. Together with power generation, International Power is also active in closely linked businesses including downstream LNG, gas distribution, desalination and retail.

International Power entered the Australian energy industry in 1996 and has grown to become one of the country's largest private energy generators, with assets in Victoria, South Australia and Western Australia. In the NEM our portfolio consists of 3,420MW (gross) of renewable, gas-fired and brown coal-fired generating plants in Victoria and South Australia. The International Power portfolio also includes Simply Energy, a wholly-owned subsidiary of International Power and one of the largest second tier retailers operating in South Australia, Victoria and other NEM regions.

Background

IPRA would like to commend the Commission for the thorough approach taken to assess this rule change proposal on potential generator market power in the NEM. We welcome the decision not to pursue a rule change and endorse the Commission's assessment that there is no evidence to support a rule restricting the dispatch offers of generators in the NEM.

We further support the AEMC's conclusion that such a rule change would potentially result in a number of perverse outcomes such as acting as a disincentive for new generators to enter the market, reducing the long-term reliability of supply to consumers and increasing prices with supply failing to keep pace with demand growth.

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IPRA has made submissions throughout the proposed rule change process (initial consultation paper, directions paper and the NERA technical paper) and consistently argued against the rule change proposal.
In summary we argued that a rule to restrict the dispatch offers of generators in the NEM would undermine the competitive framework upon which the NEM is based and would only increase regulatory uncertainty and perversely increase barriers to entry. We considered that the NEM should be a single market for any assessment of market power and argued that the proposed approach of determining a theoretical long run marginal cost (LRMC) to assess prices against was unworkable and inconsistent with the approach taken by investors in the NEM.

Specific comments on the draft determination

Having responded to the NERA technical paper on "Estimating Long Run Marginal Cost in the National Electricity Market" IPRA reviewed the outcomes of NERA's analysis in Section 6 of the draft determination which compared NEM prices and calculated LRMC prices.

IPRA supports the conclusion derived from the NERA analysis that there is no evidence of market power in the NEM. We also agree with the Commission in its view that wholesale prices above LRMC do not necessarily signal the existence of substantial market power. Wholesale prices principally reflect underlying supply and demand dynamics. While the NEM has experienced periods of high wholesale prices, these have typically resulted from unique supply-demand conditions (for example drought) and have never been sustained over a protracted period. Excluding the unique supply-demand periods, wholesale prices have declined in real terms and this has been especially the case in recent times.

In our submission to the technical paper we argued that in order to calculate LRMC, a range of key parameters need to be selected and fixed for the life of the plant. These include:

- Capital costs
- Transmission connection costs
- Fuel costs
- CO_2 emission costs
- Operating and maintenance costs
- Capacity factor (time series, uncertain)
- Return on investment – including a risk premium
- Ongoing transmission costs
- Technology risk (potentially stranding of assets/shortening asset life)

We maintain that in reality, many of these parameters will be uncertain and change over time, and the return on investment criteria when applied over the entire asset life is most likely to be front loaded. Given the high degree of uncertainty involved in all aspects of any LRMC calculation, it is unlikely that the calculated prices would be representative of market prices over the long term.

In addition, generating plant cannot run at a loss for extended periods without becoming insolvent. It must earn adequate returns in the short to medium term, and not only over the life of the asset. The analysis performed by NERA suggests perfect foresight and undervalues the risks faced by merchant generation investors in the NEM, where assets are exposed to market and regulatory risks, and there are heightened uncertainties over climate change policies, fuel costs (for example LNG related prices) and cost of CO_2 emissions.

While the NERA analysis was methodical and comprehensive we find it led to an unacceptable approximation of the risks faced by investors considering merchant generation in the NEM. Therefore it remains our position that the investors perspective on LRMC in the NEM will be significantly higher than LRMC costs calculated based on a theoretical approach.

Conclusion

IPRA strongly endorses the Commission's decision not to make a rule change in relation to the potential exercise of market power by generators in the NEM.

If you have any questions in relation to this matter please feel free to contact Mr. David Hoch on 0417 343 537 or Mr. Greg Hannan on +61 3 9617 8405.

Yours sincerely

Stephen Orr
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International Power GDF SUEZ Australia