

**Australian Energy Markets Commission (AEMC)**

**Att:** Richard Owens, Project Leader

Submitted via [www.aemc.gov.au](http://www.aemc.gov.au)

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## **Re: Potential Generator Market Power in the NEM**

Consultation on Directions Paper

**Dear Richard,**

Please accept this letter as the SACOSS Submission to the referenced Rule Change Proposal.

### **Introduction**

SACOSS broadly supports the Rule Change Proposal by the MEU. In particular SACOSS supports the need to thoroughly investigate the issues raised by the Rule Change Proposal.

SACOSS is concerned by the Directions Paper's focus on the semantics of the issue. SACOSS attended the Public Forum in Adelaide in October 2011 where AEMC Chairman Mr John Pierce referred to the *'pejorative undertones'* of the term 'market power'. The level of active engagement from electricity generators underlines the apparently disparaging interpretation of the term.

The focus of the directions paper on defining 'substantial market power' vs 'market power' is an interesting academic exercise but not of much interest or expected value from the perspective of SACOSS and the electricity consumers we represent.

SACOSS would encourage the AEMC to not lose sight of the situations described in the MEU Rule Change Proposal rather than the words chosen or even the solution proposed. As is clearly articulated in the proposal, situations will arise (with respect to demand) in a number of jurisdictions where a 'pivotal generator' can be assured of dispatch regardless of their bid price. This ability to inflate wholesale prices when supply is not necessarily constrained certainly warrants investigation.

It was raised at the forum that small consumers should not be concerned about the impact of this as they are 'protected' by the contract cover of retailers and the role of regulated standing contract prices. It was asserted that the high price events of January 2008 cited in the MEU Proposal (related to AGL's operation of the Torrens Island Power Station) did not flow through to the standing contract price offered by AGL. SACOSS would like this to be verified by the AEMC.

SACOSS is also concerned by the strong position taken by the AER on this matter and the history of concern from the AER (such as by AER member and ACCC Commissioner Ed Willet). The AER seems convinced that opportunistic behaviour has occurred and is likely to continue to occur to the detriment of consumers. This suggests that a genuine issue exists – not in relation to defining the terminology but in terms of the actual practices of market participants.

## The Process

The AEMC has outlined a process for handling the rule change proposal that seeks to define the problem, test for evidence and, if not found, proceed to dismiss the proposal. SACOSS is of the view that the approach outlined in the directions paper may fail to detect the evidence required.

*“... if step 2 demonstrates that there is no evidence of the exercise or likely exercise of substantial market power, the Commission expects to proceed directly to making a draft determination not to make a Rule.”*

*Directions Paper, page vi*

The evidence sought relates to market (and contract pricing) and an assessment of a Long Run Marginal Cost in the market. SACOSS would argue that the high level of variability, uncertainty and subjectivity of the component parts of this assessment is likely to result in a relatively large window of ‘acceptable’ bidding and pricing into which both acceptable and unacceptable behaviour may fall. The ‘statistical power’ of the technique proposed may therefore be insufficient to resolve the behaviour associated with the definition of ‘substantial market power’, as defined by the Commission.

SACOSS is accepting of the need for ‘transient market power’ and the need for generators to recover both fixed and variable costs from an energy only market. This is most obvious when demand approaches its peaks and certain (but not all) generators are needed for only a small number of hours per year. This should not be construed as permission for all strategic bidding to occur.

Arguably, the situations described in the Rule Change Proposal are the product of generator and interconnector capacity quanta that have been in place since before the NEM began operating. In the South Australian Torrens Island case, the size of the plant (over 1200MW in a market of around 3500MW) is probably much larger than the ‘market’ would build under current market arrangements. Similarly, the ownership of the plant by AGL (who is also the dominant retailer in SA) has been assessed and approved by the ACCC - outside of the Energy Market Institutions<sup>1</sup>.

The ACCC rationale that the asset swap should go ahead because any potential market power is no greater for the new owner (AGL) than the previous (TRUenergy) is very relevant to this submission. There may have been no material lessening of competition from the transaction but it is important to acknowledge this is not a statement about the underlying extent of potential market power due to the structural and demand attributes of the SA region of the NEM.

In a letter to the AEMC from the AER<sup>2</sup> in relation to the AEMC assessment of retail competition in SA, the AER stated:

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<sup>1</sup> ACCC Public Competition Assessment (20 April 2007) *AGL Energy Limited and TRUenergy Pty Ltd – proposed swap of South Australian electricity generation assets*

<sup>2</sup> [www.aemc.gov.au/Media/docs/AER-29b6ced1-3d29-49f2-b91c-f51fa63e707a-0.PDF](http://www.aemc.gov.au/Media/docs/AER-29b6ced1-3d29-49f2-b91c-f51fa63e707a-0.PDF)

However, the ACCC concluded that the merger itself was unlikely to result in a substantial lessening of competition in breach of section 50 of the *Trade Practices Act 1974*, because the previous owner, TRUenergy, already had the incentive and ability to exercise market power. It would appear likely that the recent combination of record demand and reduced interconnection would have led to high prices in South Australia regardless of whether the asset swap proceeded.

These statements support the notion that South Australia's notorious peak demand and limited interconnection (especially at those times of peak demand) are material contributors to the conditions that enable the apparent exercise of market power. The ability for there to be substantial or enduring market power may therefore be as much about the likelihood of the conditions appearing as it is about role of TIPS in the SA market.

SACOSS would welcome commentary from the AEMC on the relationship between the subject of this Rule Change Proposal and the matters of peak demand and interconnector capacity –both of which are being actively debated in the market at present (for example, the AEMC DSP Review and the joint AEMO/Electranet RIT-T process for an upgrade of SA's interconnection to the VIC region).

### **Summary**

In summary, SACOSS is of the view that a number of coincident market attributes can create significant opportunities for the appearance of participant behaviours that are not in the long term interest of consumers. The AEMC approach does not centre itself on these facts, rather it is centred on defining a relevant term and then seeking evidence of its appearance.

The MEU Rule Change Proposal is predicated on an hypothesis that "*Market Power exists in the NEM*". The AEMC response is to test the null hypothesis that "*Significant Market Power does not exist in the NEM*" and to then define the term 'substantial market power' and how it could be detected. SACOSS is of the view that there is a high risk of a Type II statistical error in this approach (ie an inability to detect a genuine rejection of the null hypothesis) and would encourage the AEMC to instead focus on the underlying conditions rather than relying on the ability to detect something that is extremely difficult to define let alone detect.

Please direct any questions in relation to this submission to our energy consultant Mr Andrew Nance at [andrew@stkittsassociates.com.au](mailto:andrew@stkittsassociates.com.au) or on 0403 602 444.

Sincerely,



ROSS WOMERSLEY  
Executive Director