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Department for Transport, Energy and Infrastructure

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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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Dear Mr Pierce,

Thank you for the opportunity to provide comment on the Major Energy Users' (MEU) proposed Rule change regarding Potential Generator Market Power in the National Electricity Market.

The Major Energy Users (MEU) rule change to restrict generators' ability to exercise market power has been submitted to the AEMC on the basis that the National Electricity Rules (NER) do not contain sufficient provisions that prohibit generators from exercising market power through employing bidding and rebidding strategies.

The South Australian Government fundamentally opposes generators' using bidding and rebidding strategies that exploit their market power and artificially raise prices in the National Electricity Market (NEM). NEM Ministers supported this position which resulted in the NER being amended so that a penalty of up to $1 million may now apply for a breach of the rebidding Rules.

South Australia has the peakiest demand profile in the nation, with an average daily demand of approximately 1,600 MW and a peak demand of approximately twice this amount. Accordingly, in an energy only market South Australia expects to experience high prices during periods of high demand as higher cost peaking plant is dispatched to meet demand.

It appears, however, that AGL's purchase of Torrens Island Power Station (TIPS) from TRUenergy in 2007 has exacerbated the occurrence of high price periods in South Australia. Prior to 2007, the volume weighted spot price in South Australia for the March quarter across the period 1999-2007 averaged $60/MWh. By contrast, the volume weighted spot price in South Australia for the March quarter across the period 2008-2010 has averaged $179/MWh.

In its supplementary submission to the AEMC on the *'Review of the Effectiveness of Competition in the Electricity and Gas Retail Markets in South Australia'*, AGL acknowledged that at the time they acquired TIPS, AGL was already substantially hedged in the SA market. Accordingly, after purchasing TIPS, its hedge contract portfolio together with its increased generation capacity exceeded its estimated retail customer demand in the South Australian market.

Evidence suggests that since 2007, a number of occurrences of high price periods in South Australia have been enhanced by TIPS bidding and rebidding strategies. Examples include 4 January, 10 January, 18 February and 19 February 2008, where AGL priced between 70 to 90% of TIPS capacity at close to the market price cap.

Recent observations of generator behaviour in South Australia suggest that the contract position of AGL may have changed and their ability to exercise market power has diminished. On 31 January 2011, the Energy Division noted that Northern Power Station sought to exercise market power at a demand of approximately 2,900 MW suggesting that Northern now has uncontracted capacity.

The longevity of Northern Power Station remaining substantially uncontracted is questionable. Alinta, the owner of the generator, recently applied for a retail licence in South Australia and indicated they are investigating a plan to expand into the retail electricity market in South Australia. It is understood that this is part of a broader plan to substantially grow its retail customer base to 1.5 million customers on the east coast. It is therefore likely that their generation assets in South Australia would be utilised as a physical hedge to back future retail contracts in the state.

Therefore, the question is whether generator market power is a structural problem or transitory issue related to a generator's contract position. If the latter, it may be more appropriate for competition and provisions in the *Competition and Consumers Act 2010* (formally known as the *Trade Practices Act 1974)* to minimise generator's ability to exercise market power over time.

In considering structural problems, it is imperative to note that the ability for participants to rebid is essential to the efficient and effective operation of the market.

To protect consumer interests and ensure rebidding is undertaken in a responsible manner, the National Electricity Code Administrator (NECA) introduced and the ACCC authorised the 'good faith' rebidding provision in 2002. The Energy Division however, acknowledges that the enforcement of the good faith rebidding provision has been problematic.

When introducing the provision in 2002, NECA asserted that it would be difficult to obtain direct evidence to establish that a market participant had made a bid or rebid that was not a genuine representation of that participant's intention at the time it was made. We note that a rebid is currently taken to be made in good faith if, at the time of making such an offer, there is a genuine intention to honour that rebid if the material conditions and circumstances upon which the offer were based remain unchanged until the relevant dispatch interval. Given the difficulties associated with inferring a generators' intention when rebidding, it would appear prudent to seek further clarity on the interpretation of material conditions.

The Energy Division further considers that there is little clarity on the interpretation of the term 'good faith'. If generators are engaging in deliberate exercise of market power due to ambiguity with the term 'good faith' then this represents a failure of the existing NER which needs to be resolved. However, it is expected that the judgement to be provided in the 2009 proceedings of the Australian Energy Regulator against Stanwell Corporation for alleged breaches of the 'good faith provision' will provide greater clarity on this issue.

Should the AEMC determine that generator market power represents a structural problem, then careful consideration should be given to the impact a Rule Change would have on generation investment and the potential for withdrawal of plant. Incentivising physical withdrawal of capacity has the real potential to cause economic and social impacts if increased load shedding were to result.

Contrary to the views expressed by the proponents in the proposed Rule change, the Energy Division does not believe that volatility of spot prices in the market in recent years has resulted in reduced generation investment in South Australia. In support of this view, the Energy Division notes Investec's 2010 approval to construct a new 1000MW gas-fired generator in South Australia. The first stage of the project will create 250MW of generating capacity and is due to come online in 2014.

The Energy Division is concerned that the proposed MEU Rule Change may introduce greater regulatory risk for market participants, including through increased intervention by the AER. The AER would need to make a number of determinations which could have significant impacts on the operation of the market and the viability of its participants. The potential to deter new investment or cause plant withdrawal through the implementation of the MEU Rule Change are considered to be serious concerns.

In conclusion, the Energy Division welcomes the AEMC's investigation of potential generator market in the NEM and we look forward to the AEMC addressing the concerns raised above. Should you wish to discuss this submission please contact Ms Rebecca Knights, Director Energy Markets, Energy Division on (08) 8204 1715.

Yours sincerely,

Vince Duffy
EXECUTIVE DIRECTOR
ENERGY DIVISION

26 May 2011