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Australian Energy Market Commission
PO Box A2449
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AEMC Ref: ERC0165

21st March 2014

Dear Commissioners,

RE: National Electricity Amendment (Generator ramp rates and dispatch inflexibility in bidding) Rule 2014 – Consultation Paper

Thank you for the opportunity to comment on the Consultation Paper for the proposed change to the National Electricity Rules (NER).

As the peak body for the community services sector in South Australia, SACOSS has a long–standing interest in the delivery of essential services. Our research shows that the cost of basic necessities like electricity impacts greatly and disproportionately on vulnerable and disadvantaged people. Our advocacy is informed by our members; organisations and individuals who witness theses impacts in our community.

The South Australian Government removed price regulation and adopted the National Energy Customer Framework on February 1st, 2013. This makes South Australia the only jurisdiction to have both deregulated prices and adopted the NECF. Recent reports by the AEMC[1] and the Victorian Essential Services Commission (ESCV)[2] also highlight that South Australia continues to have both the nation's highest electricity prices and highest rates of electricity disconnections for failing to pay bills on time. This remains a priority concern for SACOSS and forms the background for this submission.

SACOSS maintains a keen interest in ensuring that the rules of the wholesale electricity market align the commercial interests of market participants with the long-term interests of consumers. Please find a detailed submission to the Consultation Paper attached.

We thank you in advance for your consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

Ross Womersley
Executive Director

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[1] AEMC 2013 Residential Electricity Price Trends www.aemc.gov.au/market-reviews/completed/retail-electricity-price-trends-2013.html

[2] ESCV Energy retailers comparative performance report – Customer service 2012-13 Table 3.2, p31 available from www.esc.vic.gov.au/Energy/Energy-retail-performance-reports

SACOSS Submission to:

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Background

Ramp rates and *dispatch inflexibility profiles* are specified by generators as a component of their bids into the wholesale electricity market and govern the manner in which generation dispatch levels can be physically changed through time by the market operator.

The Australian Energy Regulator (AER) has submitted a rule change request to the Australian Energy Markets Commission (AEMC or Commission) proposing a requirement for generator ramp rates and dispatch inflexibility profiles to reflect the technical capabilities of generating plant.

The AER considers that ramp rates and dispatch inflexibility profiles are on occasion used by generators to achieve commercial objectives and that this can be harmful both in terms of inefficient market outcomes and on the ability for the Australian Energy Market Operator (AEMO) to efficiently manage system security.

A Consumer Perspective

In the Consultation paper, the Commission is explicit about the need to:

> "… consider the risk that altered incentives, or any new technical or regulatory requirements, may lead generators to pursue similar commercial objectives through different means."

SACOSS has similar concerns. The ability of generators to exercise either transient or sustained **market power** through a variety of means – but particularly the practice of *rebidding* - is certainly not new and has been a regular feature of the South Australian Market for a number of years. The issues canvassed in this rule change proposal are important ones but should not be considered in isolation.

The AEMC considered the issue of *Generator Market Power* in its assessment of Rule Change ERC0123. Its final determination was to not make the rule proposed by the rule change proponent, the Major Energy Users Inc (MEU), nor make an alternate rule. However, the AEMC published a Fact Sheet with its final determination that focussed on the South Australian situation[3]. The fact sheet states:

> *Recognising the potential for substantial market power to exist or be exercised in the future, the AEMC has explored the possibility of making a rule which would confer on*

[3] Dated 26 April 2013, at www.aemc.gov.au/electricity/rule-changes/completed/potential-generator-market-power-in-the-nem.html

the Australian Energy Regulator (AER) a specific function to monitor the wholesale electricity market, but considers there is material doubt as to whether this function is compatible with the existing functions of the AER.

Therefore, the Commission recommends that the Standing Council on Energy and Resources (SCER) consider conferring on the AER such a monitoring function, and add accountability mechanisms to the AER's current information gathering powers in relation to this monitoring function.

An appropriately developed monitoring regime is a pre-requisite for identifying at an early stage any evidence that the efficient operation of the wholesale electricity market is constrained by the presence of significant barriers to entry or other features of the industry structure.

The monitoring would allow identified constraints to be addressed in the long term interests of consumers based on an understanding of the underlying cause(s).

This approach was supported by a number of stakeholders including the SA Minister for Mineral Resources and Energy.

SACOSS notes that this was discussed again at the December 2013 meeting of the Standing Council on Energy and Resources (SCER)[4]:

Other matters considered by Ministers*:*

Market Power

SCER noted advice from officials on the potential need for amendments to the National Electricity Law (NEL) to introduce a new wholesale market monitoring function for the Australian Energy Regulator (AER). SCER requested that officials further define requirements of and approach to a market monitoring function in the NEL.

The issues raised in the AER rule change proposal mark a return to issues tackled in a Rule Change of 2009 (AEMC Ref ERC0065) based on market events in 2005. The MEU's "Generator Market Power" Rule Change proposal stemmed from participant behaviour dating back to 2007.

Further, issues of market power are also the basis of a Rule Change proposal recently lodged with the Commission by the South Australian Government "Bidding in Good Faith Provisions (September 2013)"[5].

These issues are particularly important in South Australia where wholesale and retail electricity markets are highly vertically integrated. Based on market data (from AEMO, ESCOSA and the AER), SACOSS estimates that 99% of retail electricity customers (households and small businesses consuming less than 160 MWh of electricity per annum) are supplied by only 5 vertically integrated energy businesses: AGL Energy (including

[4] Refer to SCER Meeting #5 – 13 December 2013 – Communiqué available from www.scer.gov.au/meetings/
[5] The AEMC has not commenced consultation on this rule change request but it is referenced in the consultation on ERC0165.

subsidiary retailer Powerdirect), Origin Energy, Energy Australia, GDF Suez Australia (Simply Energy) and Infratil (Trustpower and Lumo).

The recent Australian Competition and Consumer Commission (ACCC) decision to block AGL Energy's proposed acquisition of the NSW Government's Macquarie Generation portfolio – the largest Generator in the NSW region of the NEM - has also resonated with South Australian consumers[6]. It is now a matter of speculation as to whether South Australian consumers would be so concerned about issues of Market Power had the ACCC made a similar determination in relation to AGL Energy's purchase of Torrens Island Power Station – the largest Generator in the SA region – in 2007[7].

Further, the December 2013 SCER Meeting considered work by AEMO on a Demand Response Mechanism (DRM) [8] – a mechanism recommended by the AEMC in its *Power of Choice Review* and referred by the SCER to AEMO to develop a rule change proposal. The DRM has the potential to erode Market Power by allowing demand reductions to effectively compete with generators at times of peak demand. SACOSS is aware of strong opposition from generators including a widely circulated critique by AGL Energy's manager of wholesale market regulation on the day before the SCER meeting[9]. At the meeting, the SCER took the unusual step of requesting AEMO to defer lodgement and; "… undertake further work" before reporting back in 2014[10].

SACOSS also notes that the AER has highlighted rebidding by AGL Energy and GDF Suez as a key factor behind price spikes in the SA Region on 19 December 2013[11].

In summary, various energy market reviews have identified the potential for market power to be exercised in the South Australian wholesale electricity market and SACOSS is increasingly concerned by the lack of concrete action.

SACOSS strongly believes that energy businesses as well as the energy market institutions (SCER, AEMC, AER and AEMO) need to be held to account in protecting the consumer interest in these matters and restoring faith in the NEM.

The issues canvassed in this rule change proposal are important ones but should not be considered in isolation – the underlying issues are much larger.

The Consultation Paper incorporates a series of questions. SACOSS is not in a position to provide a response to the more technical of these questions but does respond to a number of others in the following section.

[6] http://registers.accc.gov.au/content/index.phtml/itemId/1147200/fromItemId/751046
[7] http://registers.accc.gov.au/content/index.phtml/itemId/784137/fromItemId/751043
[8] http://www.aemo.com.au/Electricity/Market-Operations/Demand-Response-Mechanism
[9] Simon Camroux "Flirting with a dicey NEM fix" *Business Spectator* 12th December 2013 available from www.businessspectator.com.au/article/2013/12/12/energy-markets/flirting-dicey-nem-fix
[10] Refer to SCER Meeting #5 – 13 December 2013 – Communiqué available from www.scer.gov.au/meetings/
[11] *Prices above $5000/MWh – 19 December 2013 (SA)* www.aer.gov.au/node/23875

SACOSS Response to Questions posed in the Consultation Paper

Question 3

(a) Is it valid to conclude that changes in the merit order of dispatch results in productive efficiency losses?

(b) Is there a difference in productive inefficiencies caused by the rebidding of ramp rates and other forms of bidding behaviour?

(c) Assuming productive efficiency losses can be caused by other forms of rebidding, would the AER's proposed rule reduce the extent of productive efficiency losses?

SACOSS is of the view that all avenues of efficiency losses should be closed off. It will no doubt be possible to argue that the impacts of ramp-rate rebidding is minor compared to other forms of rebidding (as alluded to in Question 3(c)) but given the lack of concrete action on these other opportunities SACOSS does not consider this as a justification for inaction.

Question 4

(a) To what extent have participants experienced a quantifiable increase in the costs of managing wholesale market risks through higher risk premiums on hedge contracts and, if so, to what extent can this be attributed to the issues discussed above?

(b) Assuming the adoption of a prudent risk management and purchasing strategy, do these higher risk premiums represent a real and measurable cost to consumers?

SACOSS would suggest that if the behaviour has no "real and measurable cost to consumers" then it can have no "real and measurable" benefit to generators since they generate all of their revenue from electricity consumers. Clearly, the behaviour has some benefit to generators otherwise they would not engage in the practice. The "prudent risk management" of Question 4(b) refers to the risks imposed on the financial relationship between retailers and generators. Not only are these often the same business, but the cost of this is inevitably transferred to consumers. The prudent management of unnecessary risks is no substitute for removing these risks in the first place.

Question 5

(a) **To what extent has the rebidding of ramp rates under constraint conditions led to inefficient price signals? Is there evidence to suggest this has led to investor uncertainty?**

(b) **Have participants with peaking generators experienced higher levels of price unpredictability arising from the issues discussed above? Can these impacts be quantified?**

SACOSS is firmly of the view that such behaviour delivers price volatility that unnecessarily exacerbates both the real and perceived risks of the NEM's wholesale market. As stated, the prudent management of unnecessary risks is no substitute for removing these risks in the first place.

Question 9

Would a requirement to submit ramp rates that reflect the technical capability of generating plant increase risks to generators? What form would these risks take and can they be quantified?

The consultation paper, at para 6.1.2 asks the question: "Are the use of ramp rates legitimate as a means of managing dispatch risk?" SACOSS is of the view that a mechanism such as the AMEC's recommended Optional Firm Access Model (from the Transmission Frameworks Review) represents a more elegant and systemic approach to "dispatch risk". Justifying the status quo on this basis would be an inefficient alternative.

Question 11

(a) **What are the costs and benefits of requiring generators to submit minimum ramp rates for each of their individual physical units rather than a single minimum ramp rate for the aggregated total?**

(b) **Does the view still hold that the aggregation provisions can be used to manage concerns around incentives to aggregate?**

Question 11 follows a brief discussion in the Consultation Paper on the role of aggregation and the evolution of Generator portfolios in the NEM in recent years. SACOSS notes that the recently lodged "Bidding in Good Faith Provisions" rule change proposal from the South Australian Government also seeks to acknowledge the role of portfolio bidding strategies in the market. This increases concerns about dealing with the specific issues raised in the ramp rate rule change in isolation.

Question 14

Are there any other alternative approaches? To what extent could an alternative approach be based on incentives rather than relying on regulatory/technical requirements?

The Consultation Paper states (p33):

> "… the Commission is also conscious that altered incentives, or any new technical or regulatory requirements on ramp rates, may lead generators to pursue similar commercial outcomes through alternative means. For example, consideration would need to be given to whether a reduction in the ability of generators to influence dispatch levels through rebidding ramp rates may be replaced by an increase in the extent to which generators rebid capacity into negative price bands to achieve the same outcome. As mentioned previously, many of the costs associated with generators rebidding ramp rates under constraint conditions can be associated with other forms of rebidding.
>
> As noted, the rule change request recently received from the South Australian Government relating to the good faith bidding provisions in the NER will represent an opportunity to assess potential inefficient costs associated with all forms of generator bidding and rebidding. This may include costs where the rebidding of ramp rates may be a contributing or supporting factor but which is not necessarily the principal or underlying cause."

SACOSS tends to agree that there are other incentives and opportunities for Generators, and particularly, generator-retailers to exercise either transient or sustained **market power** through a variety of means – but particularly the practice of *rebidding*. The issues canvassed in this rule change proposal are important ones but should not be considered in isolation.