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Mr Richard Owens
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Dear Richard,

National Electricity Amendment (Potential Generator Market Power in the NEM Rule 2011)

TRUenergy welcomes the opportunity to provide comments on the Australian Energy Market Commission (AEMC) Potential Generator Market Power Rule Change.

TRUenergy is a generation developer, owner and operator as well as one of the largest retailers in the NEM.

The Proposed Rule Change has a direct impact on our business. As a generation developer the Proposed Rule Change dilutes the case for developing new generation facilities, as an owner and operator of existing plant the Proposed Rule Change impacts significantly on the pricing and sale of electricity from our sites, impacting on the revenue of the business. Finally as a retailer (who at time has exposure to high prices) this proposal seeks to undermine legitimate hedging strategies we invested significant time and resources into developing, including a number of exotic financial products, and the development of demand response options.

In summary we have four key points that we seek to raise in our submission. These are:

1. Transient market power is a necessary feature of the NEM energy only market design;
2. Responsibility for price risk management;
3. The impact on short term price signalling; and
4. The impact on long term price signalling.

In addition we provide answers to the AEMC's stated questions.

Transient Market Power in the NEM

The Proposed Rule Change seeks to eliminate the use of transient market power in the NEM. The existence and the exercise of transient market power is a feature of the Australian National Electricity Market (NEM). A number of reviews conducted by the AEMC or the Reliability Panel highlight the need for transient market power in an energy only NEM. More recently the AEMC's Review of the Energy Market Frameworks in light of Climate Change Policies states:

"Market power is, and will continue to be, a feature of wholesale electricity markets. Fundamentally, this reflects the very short timeframes within which

electricity markets clear, and the limited scope for bulk storage or demand response as means of mitigating market power. Persistent high prices in the spot market are a key signal for new investment. Thus, protection for customers over time is provided through the dynamic of new investment to compete away excess profits. In addition to the cost discipline imposed by competition over time, there are regulatory and legal safeguards. The NER places obligations on generators to make generation offers in good faith and provides for regulatory scrutiny and reporting of high price events. The Trade Practices Act 1974 (Cth)(TPA) also provides for oversight of general competition issues, including generator bidding behaviour, by the Australian Consumer and Competition Commission (ACCC)."¹

The Proponent's Rule Change Proposal seeks to eliminate this feature of the NEM but does not then provide compensatory measures for investment signalling and the recovery of fixed operating and capital costs. This is analogous to buying a call option without paying a premium or a move to a capacity market without capacity payments. As such the Proponents Proposed Rule Change would leave the NEM unsustainable and is therefore not consistent with the National Electricity Objective (NEO).

Managing Price Risks

It is also concerning that participants seek to request the regulator to change market rules as a means to managing their own spot price risks i.e to seek someone else to "pay" to manage their risks. In this case consumers in the future would pay higher costs for energy due to the dilution of generation and demand response signals. Seeking a regulatory solution to a market price risk problem raises a moral hazard issue.

Recently the New Zealand Electricity Authority (EA) consulted on a *undesirable trading situation* (UTS) in response to a generator offering and setting very high spot market prices (circa \$20,000MW/h). The actions proposed and consulted on by the EA would reduce the market price. Genesis Energy made this comment in their supplementary submission to the EA.

"The submissions received by the Authority have only reinforced our perspective. The submissions broadly divide into two camps: on one hand submissions from those on the demand and supply side of the market who adequately managed their commercial risk according to the known and foreshadowed market conditions and, on the other hand, those who did not. The latter group are seeking to mitigate through ex post regulatory intervention the commercial consequences of their freely made risk management decisions. In Genesis Energy's view, the only choice open to the Authority is to apply the market rules as they stand, and reward good risk management behaviour. It should not reward poor decision making with all the consequent moral hazard that that decision would entail."²

The following comment was offered in the Norske Skog submission (a major energy user) in relation to the to the New Zealand EA UTS

"The Authority argues that consumers were not well enough prepared to respond to the high prices of 26th March 2011, and this justifies a UTS. We are quite perplexed about this conclusion – given that we saw the prices coming and took action to avoid them. Our view is that the electricity market is at times completely unpredictable and one should "expect it when you least expect it". Regardless of what our contract position is our operations staff has strict guidelines concerning action to take when prices reach certain thresholds. Our strategy is very simple and we do not understand why other parties could not adopt something similar. Our view is that parties exposed to the spot market should have strategies in place to deal with unexpected spikes. This includes:

1. Price notification in real time

1 AEMC 2009, Review of Energy Market Frameworks in light of Climate Change Policies: Final Report, September 2009, Sydney

² Genesis Energy supplementary submission <http://www.ea.govt.nz/our-work/consultations/uts/26Mar11/submissions-for-draft-decision-regarding-alleged-uts-on-26-march-2011/>

2. Load shedding procedures
3. Cap contracts if load can not be easily or reliably shed"³

All the options proposed by Norse Skog are currently available in the NEM. Furthermore the NEM has the additional protection measures of the market price cap to mitigate very high market prices, and the administered price period to mitigate against extended periods of high prices.

Fundamentally the Proposed Rule Change moves the responsibility from market participants from managing spot price risks to the regulator. If this Proposed Rule or similar is implemented then it creates a moral hazard and sets the precedent for participants to seek regulatory intervention to manage spot market price risks as opposed to the participant managing their own spot price risks, both in the short and long term.

Short term price signalling

High prices are often coincident with high (often record) levels of demand, a shortage of generating capacity, and/or transmission constraints. It would be a very rare set of circumstances where high prices are not heavily influenced by the level of demand, a shortage of supply or constraints in the transmission system. These factors indicate that the market is operating at near its full capability driving high price events.

The Australian Energy Market Operator (AEMO) relies on short term price signals in regions to trigger suitable responses to tight operating conditions. These responses could be increased generation from non-committed generation, changes in transmission network configuration, and demand side response. The dilution of these price signals to real time participants increases the operational risks for AEMO in managing real time system security. Ultimately this could lead AEMO to having to intervene in the market and issue directions.

Long term price signalling

TRUenergy is significantly concerned that long term price signalling will be diluted under the Proposed Rule Change. The exercise of transient market power provides investment signals so that the NEM will have the capability to meet future levels of demand. The Reliability Panel was fully cognizant of the issue of transient market power in its most recent Report on Reliability Settings. It was noted that transient market power acts to improve levels of contracting, and demand side response in the short term and in the long term improve market competition through investment in generation and demand side response.

"A significant increase in the MPC may reduce the opportunities to exercise transient market power in a competitive market. That is, in the short-term, the possibility of higher prices may increase the level of contracting in the energy market, thus reducing the incentive to exercise transient market power. In the long-term the potential of higher prices is likely to encourage increased generator and demand side investments, thus increasing competition at times of high spot prices. If the market is not fully competitive, an increase in the MPC may increase the potential for higher spot prices and hence the financial impact at times when market participants exercise transient market power. The likelihood of high prices during periods of scarcity is a natural outworking of the energy only market and, therefore, necessary to encourage sufficient investment."⁴

As a generation developer TRUenergy has invested \$100M's in new generation and plans to continue investing in the NEM (assuming a sensible transition to a low carbon environment). For this to occur we need to be sufficiently satisfied that an efficient rate of return is possible and that this return reflects the long dated assets risks. We need sustainable market frameworks are able to provide the revenue for our investments; otherwise we face the decision of not investing in the NEM.

³ Submission Norske Skog Tasman <http://www.ea.govt.nz/our-work/consultations/uts/26Mar11/submissions-for-draft-decision-regarding-alleged-uts-on-26-march-2011/?start=20>

⁴ AEMC Reliability Panel 2010, Reliability Standard and Reliability Settings Review, Final Report, 30 April 2010, Sydney

The following section seeks to respond directly to the questions posed by the AEMC.

Question 1: What is market power in the context of the NEM?	
1.1 What is an appropriate definition for the relevant market in which to examine whether market power is being exercised? What is the relevant product, functional, geographic and temporal dimensions?	<p>The National Electricity (South Australia) Act 1996 (Act) makes provision for the operation of a national electricity market. The Act defines the national electricity market as (a) the wholesale exchange operated and administered by AEMO under this Law and the Rules; and (b) the national electricity system.</p> <p>The conception of a national electricity system is further supported by the inclusion of the definition of an interconnected national electricity system.</p> <p>The temporal dimension should be guided by AEMC (2009),pg 91 "...protection for customers over time is provided through the dynamic of new investment to compete away excess profits"</p> <p>Therefore the appropriate definition of the market should only include the wholesale exchange operated and administered by AEMO and the geographical coverage are all the interconnected regions in the NEM (as one market) and the time frame should be consistent with the time to develop new investment (either generator or demand side) that will compete away the excess profits.</p>
1.2 How should market power be defined in the context of the NEM?	The current definition in the CCA should suffice for defining market power subject to the definition of market as discussed above.
1.3 Do barriers to entry in the market exist such that the exercise of market power would not be constrained by potential entrants?	<p>Market power can be mitigated by increasing levels of competition. In an interconnected market, competition can either be inter or intra regional.</p> <p>As a generation developer TRUenergy is of the view that there can be, at times, significant hurdles to overcome to enter into the market. These hurdles include a number of the issues already raised by the AEMC in the Strategic Directions⁵ such as investment certainty, the application of competition benefits in the RIT-T and the connections process.</p> <p>However despite these hurdles new generation is entering into South Australia, the region the Proponent purports to indicate as impacted by market power. The existence of high prices in SA has provided investment signals as intended by the market design.</p> <p>TRUenergy has recently commenced commercial operation in April 2011 of a 22MW extension to Hallet power station and the Roaring 40's (50% owned by TRUenergy) Waterloo wind farm (111MW) commenced commercial operation this year. Over time additional levels of generation would reduce the ability of parties to exercise transient market power. (as intended by the market framework)</p>
Question 2: What is 'exercise' of market power in the context of the NEM?	
2.1 Are the existing competition law tests for 'taking advantage' or 'abuse' of market power an appropriate test in the context of this Rule change request?	Yes the existing definitions are appropriate in this Proposed Rule Change context. The NEL specifically refers that these issues are handled by ACCC and not recommend the AEMC replicate their role. We do not see any deficiencies in the CCA in this regard.

⁵ AEMC Strategic Directions

2.2 Alternatively, should the Commission develop a different test for assessing whether market power has been exercised in the context of generation in the NEM? If so, what elements might it contain? For example, should it contain the concepts of sustained price rises above the competitive level and/or profitability?	Transient market power is a feature of the NEM and that this transient market power is expected to be competed away by the entry of new investment. If the AEMC does develop a test then it would need to make the distinction between transient market power and enduring market power.
Question 3: What impact is the exercise of market power likely to have on efficiency?	
3.1 How might the exercise of market power impact on allocative efficiency in the NEM?	Allocative efficiency would reduce as the regulator would become the party that effectively manages spot market price risks instead of requiring participants to seek the least cost approach to managing spot market price risks.
3.2 How might the exercise of market power impact on productive efficiency in the NEM?	<p>When transient market power occurs there is an immediate impact on productive efficiency (and an overall increase in cost of generation) in the NEM. However this is infrequent relative to all trading periods in the NEM over a period of several years. It is also worthwhile to note that for a significant number of trading periods in a year spot market prices are below the short run marginal costs of a new generator.</p> <p>With the proposed Rule Change the productive efficiency would be even greater. Less new efficient generation investment would be made. The existing aging assets with increasing costs, less generation competition and higher levels of demand response needed to mitigate the lack of investment, would overall increase costs to the consumer.</p>
3.3 How might the exercise of market power impact on dynamic efficiency in the NEM?	The exercise of transient market power supports the dynamic efficiency of the NEM to provide new investment signals to the market (both demand and supply side options)
3.4 What other impacts might the exercise of market power have on efficiency and/or the long term interests of consumers?	The need for (and use of) this type of regulatory intervention (ad hoc market design changes) creates uncertainty for market participants, which only serves to deter long-term commitment to the market and decrease its efficiency.
Question 4: Is there evidence of the exercise of market power by generators?	
4.1 Is there evidence that one or more generators in any region of the NEM has market power and has exercised that market power to increase the wholesale price? Please provide specific examples and evidence to support your response.	<p>TRUenergy has no evidence to support that misuse of market power is occurring in the NEM as defined in s46 of the CCA.</p> <p>It should be noted that the number of periods where high prices occurred were coincident with transmission constraints and/or record levels of demand. Under these circumstances the high prices are a signal that the system is nearing maximum capability.</p> <p>Furthermore the number of incidents of high prices is a very small percentage of time.</p>
4.2 Do you agree with the Proponent that the conduct referred to in the Rule change request constitutes an exercise of market power? If so, do you	TRUenergy agrees that generators are capable of exercising transient market power in the NEM. This is a design feature of the NEM that intends to signal demand response, provide an incentive to contract load for fixed prices, and indicate that new investment is needed.

consider that this conduct is currently continuing and is likely to continue in the future?	We also note that at times of very high demand all generators would have transient market power, as do demand side actors.
Question 5: Will the proposed Rule effectively address the exercise of market power?	
5.1 Do you consider that the proposed Rule is likely to prevent or constrain the ability of generators to exercise market power in a manner that reduces efficiency in the NEM and adversely affects the long term interests of consumers (if there is evidence of any such exercise of market power)?	<p>The spot market operates under a marginal pricing regime and all generators receive the marginal price. The Proposed Rule will impact on generators who are not dominant as they will also be effectively capped (as the dominant generator must offer all generation up to \$300). This will reduce the ability of "price takers" to receive revenue to recover fixed capital and operating costs. The only way for "price takers" to reduce this effect would be to "economically withhold" generation to a price higher than the cap and effectively become the price maker – they will then not be dispatched, or if they are dispatched then by definition they would also be dominant and subject to the \$300 rule.</p> <p>The Proposed Rule Change is fundamentally flawed as it does not recognise that all capacity has market power when only one MW of capacity has market power in the NEM.</p> <p>Price based intervention in the market will undermine both the signals needed by investors of new generation and demand response by consumers. Fundamentally the Proponents proposal seeks to remove the need for spot price risk management from participants to the AEMC.</p>
5.2 How are other generators that are not declared to be a 'dominant generator' likely to change their behaviour if the proposed Rule is made?	All existing generators and retailers would need to reconsider their pricing and hedging strategies in light of the change in market design. TRUenergy is unable to specifically comment on its own or the response of other participants production, pricing, and hedging strategies.
5.3 Should any Rule change that seeks to address the exercise of market power by generators also address tacit collusion or parallel behaviour by generators, or is it appropriate to limit the Rule change to the unilateral exercise of market power?	TRUenergy does not believe that this Proposed Rule Change is warranted for unilateral action and by extension no consideration should be given to parallel behaviour and that these issues are best dealt with via the CCA.
Question 6: What other options could effectively address the exercise of market power?	
6.1 Do you consider that there are other options that could prevent or constrain the ability of generators to exercise market power in a manner that reduces efficiency in the NEM and adversely affects the long term interests of consumers (if there is evidence of any such exercise of market power)?	<p>Improving the incentives for demand side to manage high priced events (not just market power) would improve the overall efficiency of the NEM, with the benefit of providing downward price pressure.</p> <p>The other noticeable issue is the extent to which high prices events are coincident with transmission constraints (notably inter regionally). If the AEMC determines that transient market power exists to a significant effect and over a long duration that then it would be worthwhile to re-assess the extent that inter-regional transmission constraints are contributing to this issue and review the competition benefits of the RIT-T.</p>
6.2 If so, are those options likely to better to better contribute to the achievement of the NEO than the proposed Rule, and why?	Both options would be preferable because they reduce the level of regulatory intervention in the market. TRUenergy notes that these are already under consideration by the AEMC by the Demand Side Participation Review and the Transmission Frameworks Review

Question 7: What are the likely impacts of the proposed Rule on the achievement of the NEO?	
7.1 What impact is the proposed Rule likely to have on wholesale electricity prices?	Over time it would be expected that wholesale electricity levels would increase as a consequence of reduced investment in the NEM.
7.2 What impact is the proposed Rule likely to have on efficient investment in generation, in particular incentives for efficient entry of new generation?	<p>There are 2 impacts to the potential incentives for efficient entry of new generation.</p> <p>The proposed rule change seeks to remove the transient market power feature of the NEM without providing a compensating signal for new generation. This would reduce the motivations of investors to enter the market.</p> <p>The second key impact would be the perception of increased regulatory risk, in this case towards a system of regulatory price risk management, as opposed for ensuring that participants manage their own risks. The consequence of this type of event is that investors would be reticent to enter the market because the regulator has already shown the propensity to change market design to manage participant's risk, and therefore is likely to do so again.</p>
7.3 What impact is the proposed Rule likely to have on the efficient use of electricity services?	Since the exercise of transient market power also occurs in conjunction with high levels of demand and/or transmission constraints the proposed Rule would seek to dampen real time price signals, thus removing the incentive for other generators (who are not fully committed, and demand response) to respond. This would directly impact on the ability of AEMO to manage the system in a secure state.
7.4 What impact, if any, is the proposed Rule likely to have on the market for electricity derivative products and/or the retail electricity market?	This rule is likely to undermine the need for electricity derivatives as it reduces the need for parties to manage price risks, as spot market price risks are managed via rule change proposals to the Regulator. This directly reduces generation investment.
7.5 Do you consider that the proposed Rule is likely to have any other impact on the achievement of the NEO?	The Proposed Rule Change is a move away from the NEO and fundamentally changes the market design in an ad-hoc manner without considering the downstream impacts. For example the MPC is set in the context of the current market cap and this would need be adjusted (upwards to ensure that investment signalling is retained)

Finally TRUenergy thanks AEMC for the opportunity to provide a submission on this very topical issue and looks forward to working constructively with AEMC on ensuring that Australia has an efficient energy market. Please feel free to contact me on (03) 8628 1632 should you wish to further discuss this submission.

Yours Sincerely,



Lana Stockman
Manager, Wholesale Regulation
TRUenergy

