



public interest
ADVOCACY CENTRE

**Approach to the AER's electricity wholesale
market performance monitoring**

20 October 2017

1. Public Interest Advocacy Centre

PIAC is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training.

PIAC's Energy + Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group.

2. Introduction

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to respond to the AER's discussion paper.

PIAC strongly supports the AER's monitoring of wholesale markets. An essential outcome of this is to not only provide an independent assessment of the performance of wholesale markets but also for the AER to propose policy, regulatory or procedural reforms to the COAG Energy Council and other market institutions.

Prices in any market will experience volatility. This is especially true in an energy-only wholesale market that is intended to allow generators to recover their capital costs as well as to provide a signal for new generation investment. However, central to assessing the performance of wholesale markets in the National Energy Market (NEM) is being able to distinguish between cases where high or volatile prices are a sign of an effective market and cases where this is caused by excessive market power or another form of market failure.

PIAC appreciates the complexity of assessing the efficiency and effectiveness of wholesale markets given the various products and services involved, all of which contribute to the cost that is ultimately passed on to consumers.

Given this complexity, spot prices alone do not tell the whole story and the effectiveness of wholesale markets cannot be accurately represented in a single measure. There is a wide range of separate market products and services that the AER should consider when monitoring the performance of wholesale markets, noting that these will differ based on the region and timescale being examined. These are described further in response to Questions 3 to 7.

3. The AER as an expert regulator of wholesale markets

PIAC recommends the AER has as wide a remit as possible in performing its monitoring, compliance and enforcement role, and prioritises its work based on the observed or potential harm which may result from non-competitive behaviour in a given market, region and timescale – i.e.: the higher the potential harm, the higher the priority the AER should assign to the analysis.

The harm, in PIAC's view, is costs to consumers that are inefficient or higher than they should be.

PIAC supports the AER having flexibility and using its discretion to analyse wholesale markets and market behaviour as required. More broadly, PIAC encourages the AER to approach its tasks and role as an expert regulator rather than a legal regulator. In the context of the wholesale energy market, this would entail the AER using its full discretion in whatever ways would assist it give primacy to the National Electricity Objective, particularly as it relates to price impacts on consumers over the longer term, and extends to seeking any changes to the Rules that would help to the AER to achieve that.

To this end, PIAC also supports the AER taking a proactive monitoring role that identifies potentially inefficient market outcomes at the earliest opportunity. To be clear, this is not necessarily a crystal ball gazing exercise where the AER seeks to forecast prices or the uptake levels of particular technologies. Rather, it involves actively gathering data to identify issues as they emerge. This is an effective way of preventing harm from occurring in the first place, rather than fixing a problem only after consumers have had to pay inefficient costs.

Given the transition currently underway in the NEM, PIAC also supports measures which may help to future-proof the AER's market monitoring role noting that new markets, participant behaviours and potential consumer harms are likely to emerge in response to policy reforms and technological changes. For instance, there may be value in developing an understanding of energy storage and its impact at the wholesale market level now while penetration levels are relatively low and before it dramatically increases, as occurred with solar generation.

Responses to the specific consultation questions are provided below.

4. Response to consultation questions

Question 1: What material should we consider in establishing our approach?

PIAC supports the AER casting a wide net and using all material it considers relevant in establishing its approach. This includes material developed as part of the Major Energy Users' rule change request but should not be limited to material developed by the AEMC. It also includes the experience of both local and international regulators as well as appropriate reports such as those by AEMO and the AEMC.

PIAC also considers that, while the use of competition law jurisprudence may provide a useful source of information, the AER should not be constrained by it in developing or conducting this new market-monitoring role.

Question 2: What factors should we consider when prioritising tools or analysis?

There is a wide range of separate market products and services that the AER should consider when monitoring the performance of wholesale markets, noting that these will differ based on the region and timescale being examined. These are described further in response to Questions 3 to 7.

Therefore, as noted in our introductory comments, PIAC recommends the AER prioritise its work based on the observed or potential harm which may result from non-competitive behaviour in that particular market, region and timescale – i.e., the higher the potential harm, the higher the priority the AER should assign to the analysis.

PIAC considers that the four criteria proposed by the AER – probative value, robustness, accessibility and practicality – support this by focussing on the ability of the AER’s monitoring work to address the observed or potential harm.

While monitoring alone may not directly address particular harms, there nonetheless remains significant value in the AER drawing attention to emerging issues through its public and transparent reporting. Doing so may deter bad behaviour, highlight opportunities for new entrants to enter the market, and identify where the current rules, policies or procedures need to be changed

Questions 3, 4 and 5: What are the relevant products?

PIAC considers that there are a number of separate, yet interrelated, markets that the AER should consider. The wholesale energy market is an obvious candidate for inclusion but PIAC recommends that the AER also consider any other market, product or service that materially impacts the final price paid by consumers. This would be consistent with the AEMC and ACCC’s reviews of retail electricity markets where all factors associated with the final retail prices paid by consumers are considered.

Therefore, PIAC recommends that the AER should include the following markets in addition to the wholesale energy market:

- Ancillary service markets – existing markets such as FCAS, NSCAS and SRAS as well as any new ancillary markets that may be formed, such as the proposal for inertia services. In particular, PIAC recommends the AER monitor SRAS in terms of the efficiency of price outcomes. This is distinct from the existing reviews conducted by AEMO and the Reliability Panel, which monitor SRAS primarily in terms of planning outcomes.
- Derivatives and Settlement Residue
- System security markets such as the Reliability and Emergency Reserve Trader (RERT)
- Gas supply – PIAC recommends the AER confirm that active and genuine efforts are being made by generators to ensure adequate fuel supply in both the short and medium term.

In examining and monitoring these markets, PIAC recommends the AER also look for levels of demand side participation in each. PIAC considers that no market can be considered to be truly efficient or effective without optimal levels of demand side participation. Without meaningful demand side participation, and without regulatory and market frameworks that enable and incentivise it, the allocative, productive and dynamic efficiency of the markets will suffer.

Question 6: What are the factors we should consider when defining the geographic dimensions of the market?

PIAC considers the AER should not limit itself to examining the NEM as a whole. Doing so would ignore the physical limitations and constraints in the physical network as well as the fact that many of the markets in the NEM are limited by design to particular regions.

In addition to constraints between NEM regions, the AER must also be mindful that there may also be constraints within a NEM region that materially impact wholesale market performance and outcomes. For instance, there have been instances where significantly different outcomes have occurred in north and south Queensland due to the network topology and the location of generation and load centres.

Question 7: What are the factors we should consider when determining the relevant period of time for our assessment?

Harms to consumers from wholesale market outcomes can come from behaviours or systemic failures over a range of different time scales. It may come from market structures which incentivise generator bidding in the last 5 minutes of a 30-minute settlement period and push the settlement prices up (which led to the bidding in good faith rule change). However, it can also come from other behaviours that may inefficiently push up long-term prices, including the failure to make capacity available in the market and other forms of exercising market power.

Therefore, the AER's scope should include the granularity to be able to examine 5-minute dispatch bidding. The AER must also be able to take a longer-term view to capture trends, systemic behaviours and the ability (or inability) for participants to enter and exit the various markets.

Question 8: What issues should we be aware of in applying the definition of effective competition in the National Electricity Law? Are there additional matters we should consider?

PIAC has not formed a view on this question but would welcome the opportunity to explore it further with the AER.

Question 9: What factors can compromise efficiency in wholesale electricity markets?

Questions 16 and 17: Identifying and measuring the extent of inefficiencies in the wholesale markets

PIAC considers that no market can be considered to be truly efficient or effective without optimal levels of demand side participation, and without regulatory and market frameworks which enable and incentivise it, the allocative, productive and dynamic efficiency of the markets will suffer.

There are many other factors that compromise efficiency, such as

- gaming and the use of excessive market power,
- the pursuit of levels of reliability that exceed the value consumers place on it, and

- interventions by governments (including proposed interventions) that effect investment signals.

PIAC would welcome the opportunity to explore these issues further with the AER.

Question 10: What market concentration indicators should we consider?

PIAC supports the AER considering a range of indicators to measure market concentration in all the wholesale-related markets described our response to Questions 3 to 5.

However, PIAC notes that traditional indicators of market concentration are based on markets where all participants actively participate in setting market prices. Fundamentally, they try to measure how many firms there are setting prices in the market since the more firms are involved, the less chance for any one to wield excessive market power.

However, this may not directly apply in the wholesale energy market where many renewable generators bid at, or close to, zero. At the timescale of dispatch intervals, these generators are not often involved in price-setting and are more passive price-takers. Therefore, at least when looking at the dispatch interval timescale, using these indicators with all generators, including those bidding at zero, might overestimate the level of competition and underestimate the level of market concentration. When looking at the longer-term, including all generators including those bidding at zero may be more appropriate as they would play more of a role in setting long-term prices by exerting consistent downward pressure of spot prices.

Question 11: What are the relevant sources of potential barriers to entry? What methods should we use to assess these barriers?

PIAC has not formed a view on this question but would welcome the opportunity to explore it further with the AER.

Question 12: What are the issues we should consider regarding horizontal or vertical integration in the wholesale energy markets?

PIAC supports the AER examining the impact of both vertical and horizontal integration in wholesale markets. Where vertical and horizontal integration occurs, PIAC recommends the AER examine whether the benefits available from efficiencies of scope and scale are passed on to consumers to offset the potential detrimental impact such integration may have on levels of competition including barriers to entry.

Question 13: What aspects of a participant's conduct should we consider? Are there any methods or tools that might be insightful for assessing conduct?

PIAC supports extending the AER's existing review of participant behaviour in high price events to a broader remit, in terms of the timescales considered to examine longer term price trends in addition to one-off price events and markets covered (see response to Questions 3 to 5, and our introductory comments).

In particular, PIAC supports the AER investigating whether there is evidence of generators withholding capacity at strategic times to affect wholesale prices.

Question 14: How should we assess the overall performance of the wholesale markets?

As noted above, PIAC is of the view that a harm-minimising goal, where the harm is inefficient price outcomes for consumers, with the AER as an expert regulator, should guide the AER's assessment of the performance of wholesale markets.

PIAC does not consider that the performance of the wholesale markets can be assessed as simplistically as "if X indicator is above Y level, then there is effective competition."

PIAC agrees with the AER that a suite of measures is required to accurately assess the overall performance of wholesale markets, which may include both quantitative and qualitative measures. Furthermore, it is unlikely that each indicator could be considered in isolation, but the suite of measures should rather should be considered as a whole.

Question 15: How should we have regard to whether prices are determined on a long-term basis by underlying costs rather than the existence of market power?

As noted in our response to Question 14, PIAC does not consider that any one measure will accurately reflect the effectiveness of competition (or existence of market power). Hence PIAC recommends the AER employ a suite of measures that are considered as a whole rather than in isolation.

5. Further engagement

PIAC would welcome the opportunity to discuss the issues considered herein in more depth. For any queries please contact Energy Team Leader, Craig Memery at cmemery@piac.asn.au or on (02) 8898 6522.