



Potential Generator Market Power

Consultation Paper: 14 April 2011

The AEMC has started public consultation on a Rule change request in relation to the potential exercise of market power by generators in the National Electricity Market. The request has been submitted to the AEMC by an industry group, Major Energy Users Inc.

Consultation Paper

The AEMC has today published a staff Consultation Paper setting out its proposed approach to assessing this request and the key issues on which submissions are sought.

Submissions close on 26 May 2011.

The AEMC must consider any Rule change request that meets certain legislative requirements. The publication of the Consultation Paper does not indicate that the Commission has formed any views as to whether generators are exercising market power or whether the proposed Rule change should be made. Those issues will be analysed in detail as part of the Rule change process.

The problem that the request is seeking to address

The Rule change request from the Major Energy Users Inc. (MEU) seeks to constrain the perceived exercise of market power by generators in the National Electricity Market (NEM). The MEU considers that during periods of high demand when the system is operating normally, some large generators do not face effective competition and have the ability and incentive to use market power to increase the wholesale electricity spot price.

Wholesale electricity market pricing

Generators compete with each other to sell their electricity into the wholesale market by submitting offers for each 30 minute trading interval. The market determines which generators to dispatch by ranking the offers from the lowest priced to the highest priced and dispatching the lowest priced power possible to meet demand.

Wholesale electricity spot prices can vary significantly depending on the level of demand. When demand is low it can be met by generators with lower costs and the wholesale spot price is likely to be relatively low. When demand is high and the balance between supply and demand tightens, the wholesale spot price is likely to rise. Higher prices can provide an important signal and incentive for new generation investment.

The MEU is concerned that on days of very high demand, large generators are able to cause the wholesale spot price to rise more than it should by offering prices that far exceed their costs. The MEU states that this issue is a particular concern in South Australia, but is also a potential problem in other regions.

The MEU's proposal

To address this perceived problem, the MEU proposes that the Australian Energy Regulator should assess which generators have market power during periods of high demand and declare them to be 'dominant generators'.

When regional demand exceeds the level at which a generator has been declared to be a 'dominant generator', the dominant generator would be required to offer all of its available capacity for dispatch at a price that does not exceed \$300/MWh.

All other generators would remain free to offer any price up to the current market price cap of \$12,500/MWh.

The AEMC invites public submissions on this rule change proposal and Consultation Paper.

Submissions due 26 May 2011.

Assessment process

The AEMC will begin its assessment by clarifying and defining the problem that the Rule change proposal is seeking to address and then investigating whether there is evidence of that problem. If there is evidence of a problem, we will assess the costs and benefits of the MEU's proposal as well as other potential solutions to the problem.

The AEMC's assessment will be guided by the National Electricity Objective (NEO), which relates to the promotion of efficient investment and the efficient operation and use of electricity services in the long term interests of consumers.

In particular, we will consider the likely effects of the proposed Rule on incentives for efficient new investment in generation, the efficient operation of the wholesale market and the efficient use of electricity services. We will also consider whether there is a more preferable Rule that would address the problem raised by the MEU in a way that better contributes to the NEO.

Next steps for public consultation

Our assessment will involve the following key steps. Submissions will be called for at each stage.

1. **Defining the problem.** Stage one will define what constitutes the exercise of market power in the context of the NEM. It will also consider what impact the exercise of market power can have on efficiency and the long term interests of consumers.
2. **Assessing whether there is evidence of a problem.** Stage two will investigate whether there is evidence of the exercise of market power by generators in a manner that reduces efficiency in the NEM. We will also assess whether any such conduct is likely to continue without a Rule change, and whether the conduct can be adequately addressed by the Australian Competition and Consumer Commission's existing powers under the Competition and Consumer Act 2010.
3. **Assessing solutions.** If these investigations determine that there is a problem, stage three will assess solutions to that problem. We will assess whether the proposed Rule is likely to be effective and what impact it will have on achievement of the NEO. We will also consider whether there are other solutions that are likely to better achieve the NEO.

A Directions Paper addressing stage one is intended to be published in mid-2011.

The Commission has extended the timeframe for issuing a draft determination until April 2012.

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