



30 May 2011

Mr Richard Owens  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Dear Mr Owens

**REFERENCE: ERC0123 - AEMC CONSULTATION PAPER FOR POTENTIAL GENERATOR MARKET POWER IN THE NEM - AURORA ENERGY SUBMISSION**

Aurora Energy (Aurora) welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) Consultation Paper *National Electricity Amendment (Potential Generator Market Power in the NEM)*.

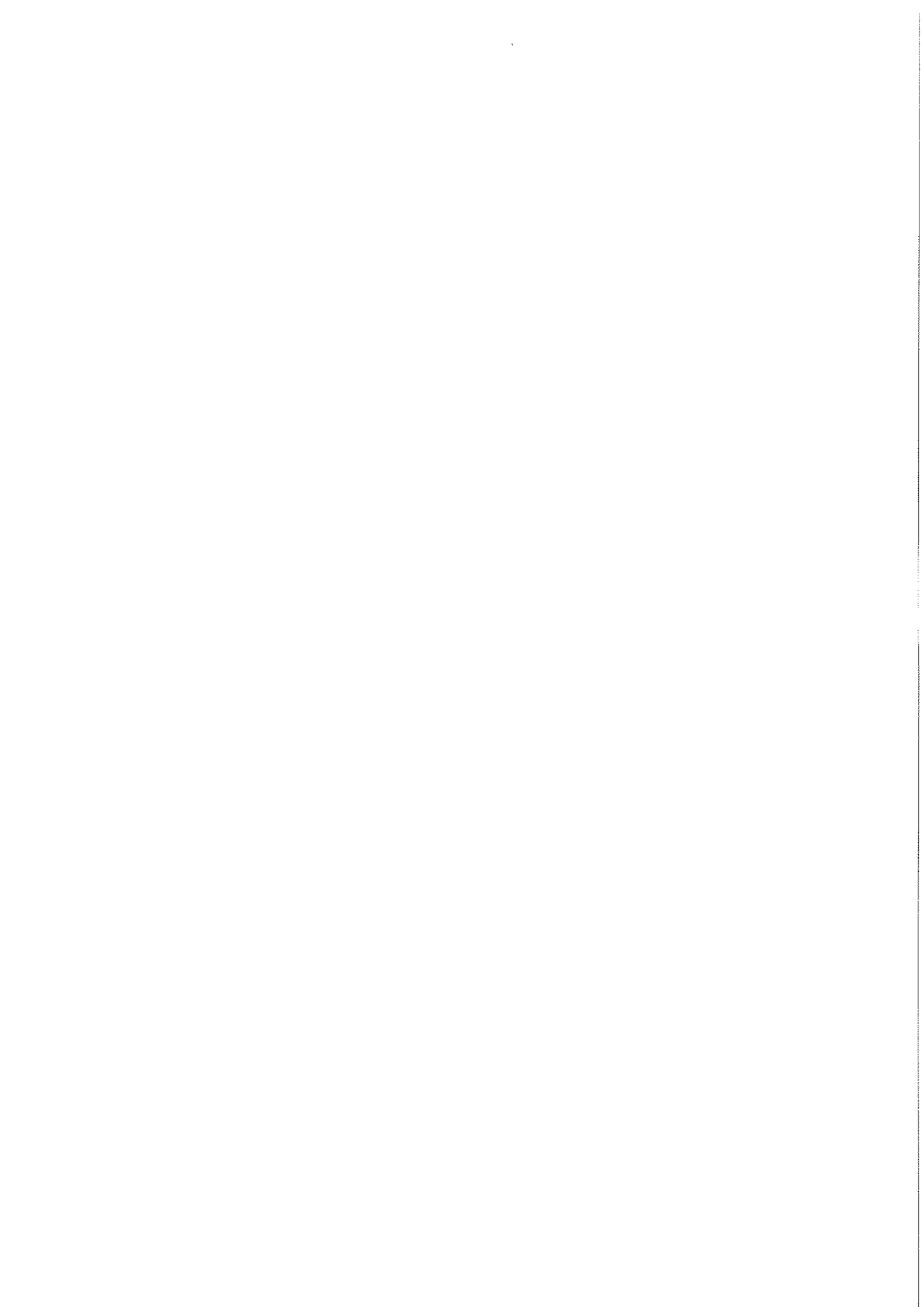
The proposed rule change highlights relevant issues for the Tasmanian wholesale electricity market as well as Tasmanian end use electricity consumers. Aspects of these relevant issues for Tasmania are also under consideration by an independent Expert Panel established to consider potential market and structural reforms in the Tasmanian energy sector.

Accordingly, Aurora has prepared this submission to highlight its support for the Rules change process and the key issues it raises for Tasmania while noting that Aurora will continue to work through jurisdictional reform processes such as the Tasmanian Expert Panel.

If you would like to discuss further any of the issues raised in the submission please contact Shaun O'Loughlin, Manager Strategic Development, 0418 139 002, in the first instance.

Yours sincerely

  
for Dr Peter Davis  
Chief Executive Officer





**AEMC Rules Change – Consultation Paper  
– National Electricity Amendment (Potential  
Generator Power in the NEM) Rule 2011**

30 May 2011

## **Executive Summary**

The Australian Energy Market Commission (AEMC) Consultation Paper *National Electricity Amendment (Potential Generator Market Power in the NEM)* ("the Paper") provides an opportunity for entities potentially affected by market power to, at a minimum, highlight issues for review in the market structure.

Additionally, the consideration by the AEMC of the proposed rule change by the Major Energy Users Inc (MEU) highlights relevant issues for the Tasmanian wholesale electricity market and Tasmanian end use electricity consumers.

Aurora Energy (Aurora) as the State owned franchise retailer and owner/operator of the Tamar Valley Power Station has been exposed to a number of very high price events caused by the bidding behaviour of the dominant generator in Tasmania. Both the Australian Energy Regulator (AER) and the ACCC have commented on such events in Tasmania over the past two years, not only the spot price market, but in the provision of ancillary services, namely the provision of raise frequency control services (FCAS).

The latter of these pricing events gave rise to an investigation of the presence and impact of market power in the Tasmanian FCAS market in the form of a 2010 FCAS Price Investigation by the Tasmanian Economic Regulator (TER). This investigation ultimately led the TER to mitigate this instance by classifying FCAS a declared electrical service.

Aurora recognises that there is great complexity surrounding the proposal from the MEU and that the final outcome of the rules change process may not directly reflect the proposed solution by the MEU. However, given recent Tasmanian wholesale electricity market events Aurora considers there is benefit in the AEMC progressing this Rule change proposal to its fullest extent to properly consider the issue of generator market power and the most appropriate ways to mitigate it.

An important jurisdictional context for this rules change proposal is that in 2010 the Tasmanian Government commissioned an Expert Panel to examine a range of factors in the Tasmanian market. The Expert Panel will be the focus of Aurora in reviewing the Tasmanian wholesale energy market structures over the coming months.

Aurora will seek to continue to engage in this rules change process as well as the ongoing Expert Panel Review as these are both critical to ensure the Tasmanian consumers are provided with low and sustainable energy costs driven by an efficient and reliable framework.

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## 1. Introduction

While the intention and structure of the National Electricity Market (NEM) is to deliver efficient market outcomes, there are observable instances where less efficient outcomes have occurred, whether caused by market dominance or not. As such, Aurora Energy ("Aurora") considers there is benefit in the AEMC examining issues of wholesale market dominance by single generation entities and supports this being done through the Rules change process.

Aurora recognises the seven key issues raised for discussion, however, the approach of this submission will be to address the broader issues highlighted by the Rules Change process and to discuss these within the Tasmanian context. Additionally, instances of assessment of market dominance by State and Commonwealth Regulators will be highlighted to emphasise the significance of the Rules Change proposal to Tasmania. The key issues that Aurora is keen to explore further in this paper are:

- Meaning of market power in the Tasmanian context;
- Exercise of market power in the Tasmanian context; and
- Rule change proposal reference and relevance to Tasmania.

In terms of future outcomes, Aurora recognises the complexity of the Rules change proposal and the implications this may have for the broader wholesale electricity market. Aurora stresses that while it considers there is merit in the continuation of the rules change process any ultimate solution to identified problems may not reflect or correspond to the solution proposed by MEU. Aurora's current focus is on the process and outcomes of the Tasmanian Energy Expert Panel Review, although we are in full support of a Rules change process at a national level.

## 2. Background

### *Aurora Energy*

Aurora is a Tasmanian Government-owned electricity distribution and retail company, which was formed in July 1998 pursuant to the Electricity Companies Act and incorporated under the Corporations Law. In 2009, Aurora completed construction of a new gas-fired thermal generation at the Tamar Valley Power Station (TVPS) and is now the owner/operator of a total of 380MW of generation.

### *Tasmanian framework*

Since the early 1990s, Australian energy markets have evolved and progressed in line with the principles of National Competition Policy (NCP) and sectoral trends such as disaggregation and privatisation. The growth of the NEM has also driven a requirement for homogeneity across participating jurisdictions. Markets such as New South Wales, Victoria, South Australia and Queensland have been accommodating of these changes in full or at the least to a large degree. However, the Tasmanian

market, and its particular historical and geographical structure, has not been as well equipped or enabled to transition to goals such as effective competition.

The Tasmanian sector has gone part way to developing a market that reflects that of the mainland. Corporatisation of the major entities has occurred and with the construction of Basslink Tasmania has become part of the NEM. However, the ability for the Tasmanian market to develop to such a stage where it could be deemed effective and capable of resolving key challenges has been hindered by the dominance of monopoly participants and fuel sources.

Hydro Tasmania currently provides the majority of Tasmanian energy generation, whether through hydro, wind or power derived from the Basslink cable, creating a single entity dominant generation market. Book ending this instance is the low rate of consumption growth in Tasmania (1.87%<sup>1</sup>) and the capability of Basslink to import and export energy. While growth of consumption in Tasmania is unlikely to change, the support from Basslink may alter depending on inflows in catchment areas.

The view that the Tasmanian market is one still under development is supported by the TER which notes the structural and contractual arrangements are not conducive to the development of competition in wholesale supply in the medium term.<sup>2</sup> Moreover, the expectations of the effectiveness of the NEM and its mechanisms do not match the characteristics of the Tasmanian market.

#### *Tasmanian Expert Panel*

In 2010 the Tasmanian Government established its own market reform program, which over the next year is to primarily be encapsulated by the Expert Panel Review. The Review has a wide scope and relevant terms of reference to the Rules change process for this submission, namely investigation of:

- The current efficiency and effectiveness of the Tasmanian energy industry with particular reference to the existing regulatory framework and the cost and operation of the energy industry elsewhere in Australia;
- The primary factors that have driven recent increases in non-contestable electricity prices in Tasmania including the impact of major infrastructure development decisions;
- The competitiveness of non-contestable electricity prices in Tasmania a compared with those in other states; and
- The impact of interaction between the state-owned businesses on the effective operation of the Tasmanian energy industry and prices.

Aurora strongly supports the independent assessment of the electricity supply industry in Tasmania and will continue to participate in all steps of the Expert Panel process.

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<sup>1</sup> <http://www.transend.com.au/files/D08-51503.PDF>

<sup>2</sup> [http://www.energyregulator.tas.gov.au/domino/otter.nsf/LookupFiles/Full\\_Retail\\_Contestability\\_Cost\\_Benefit\\_Assessment\\_Draft\\_Report\\_1.0\\_080513.pdf/\\$file/Full\\_Retail\\_Contestability\\_Cost\\_Benefit\\_Assessment\\_Draft\\_Report\\_1.0\\_080513.pdf](http://www.energyregulator.tas.gov.au/domino/otter.nsf/LookupFiles/Full_Retail_Contestability_Cost_Benefit_Assessment_Draft_Report_1.0_080513.pdf/$file/Full_Retail_Contestability_Cost_Benefit_Assessment_Draft_Report_1.0_080513.pdf) p.25

### 3. Response to Issues for consultation

#### *Meaning of market power in the Tasmanian context*

Informed observers including the Tasmanian Economic Regulator (TER), have made observations that efficient market outcomes are not being achieved in the Tasmanian wholesale generation sector. These issues have also been the focus of the ACCC and the Australian Energy Regulator (AER). The 1999 "Garlick report" also discussed the potential for wholesale market issues under the current market design. Garlick noted:

"Market power is generally considered to be a problem when an entity can use a position of market dominance to extract higher prices in sales to customers, and to impede entry of new competitors. A single HEC as generator would certainly be in a position of market dominance even with an assumption of a 300 MW Basslink in service. However it is the abuse of market power, not the possession of market power, that is the problem. In any free bidding spot market trading period, HEC could theoretically give up say 25% of market share to imports, thereby constraining the link, and then be free to set the pool price in Tasmania anywhere up to VoLL."<sup>3</sup>

The definition of market power is well covered within the consultation paper and as stated it is the "ability to raise prices above a level that is considered competitive for a sustained period, due to the absence of competition and therefore any constraint on behaviour." Aurora broadly supports this view.

#### *Exercise of market power in the Tasmanian context*

There have been two streams of recent events that serve to highlight previous instances of market power in the Tasmanian market, in the wholesale electricity market and in the provision of ancillary services, namely raise FCAS pricing.

The AER has highlighted a number of high price events that have occurred in Tasmanian and in particular the following events are worthy of consideration: 10 to 19 June 2009, 22 May 2010, 7 & 8 August 2010 and 19 November 2010.

As an example the 19 November 2010 AER market report stated that:

"On 19 November 2010, the spot price in Tasmania reached \$12 400/MWh for the 7am trading interval, the equal highest spot price ever recorded in the National Electricity Market. The high price resulted from Hydro Tasmania's bidding strategy and its control of non-scheduled generation output."

Further, the AER report observed that imports across Basslink and output from other Tasmanian generators was insufficient to meet demand. This meant that only a small amount of Hydro Tasmania's high-priced capacity was required to be dispatched and set the price.

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<sup>3</sup> Garlick, Peter (1999), "National Competition Policy Review of the Structure of the Hydro-Electric Corporation's Generation & System Control Functions", Issues and Options, p. 51.



With regard to FCAS pricing, the clearest outcome to date of concerns over market power was the action taken by the TER to regulate FCAS hedge arrangements in Tasmania as a result of market events in April 2009.

The ACCC investigation into the same event stated that:

"The ACCC considers that Hydro Tasmania's conduct has had serious implications for other market participants as well as ultimately for consumers as end purchasers of electricity. However, in this instance, the ACCC has formed the view that the evidence does not establish to a sufficient extent that Hydro Tasmania's exercise of market power was a contravention of section 46 of the TPA."

This clearly demonstrates the difficulty in addressing any "exercise" of market power under the TPA and that possible regulatory solutions should be considered to ensure efficient operation of the NEM.

With regard to the impact of 'exercising' market power consideration needs to be given to the financial market as well as the physical market. In Tasmania the sourcing of derivative products such as swaps, caps and interregional hedging is provided by the same participant who has market power in the physical market.

#### *Rules change proposal reference and relevance to Tasmania*

The Rule change request states that the Rule change proposal could have unintended effects in Tasmania and would result in Hydro Tasmania being declared as a dominant generator at all levels of demand. As a consequence the proponent suggests a possible jurisdictional derogation for the proposed Rule change to not apply in Tasmania.

Aurora does not agree with the commentary provided by the rule change proponent, and contends that Tasmania should not be excluded from consideration throughout the rules change process. Further it is incongruous for the MEU proposal to suggest market power concentration does not warrant consideration in jurisdictions where market power is concentrated with one single entity on a permanent basis. However, it is certainly true that the Tasmanian region has different characteristics to that of other NEM regions. A strong example of this is that the Tasmanian region is not capacity constrained but energy constrained, due in the main to its particular generation mix.

Aurora has been consistent in highlighting the observable deficiencies with the Tasmanian wholesale electricity market and its ultimate affect on end-use consumers. As highlighted previously, a key factor in the establishment of the Expert Panel established to review the Tasmanian market is to review the "current efficiency and effectiveness of the Tasmanian energy industry with particular reference to the existing regulatory framework and the cost and operation of the energy industry elsewhere in Australia". Accordingly, Aurora considers the current structure of the Tasmanian wholesale electricity market warrants further consideration, whether this be through reforms to governance, operational focus, or regulatory arrangements in delivering the most efficient outcome.

While the options for responding to market inefficiency discussed under section 5.6 of the consultation paper are all worth considering, without further analysis or modelling it is not apparent which solution would best address the impact of any confirmed issues. In the absence of an alternative solution Aurora stresses that the proposed Rules Change has merit and warrants further consideration.

#### **4. Conclusion**

Aurora is supportive of the commencement of the Rule change process and believes there is sufficient evidence and issues to warrant progression of the process. While Aurora considers that the regulation of raise FCAS has gone some way to mitigating the instance of market power in the provision on ancillary services there is still much scope for concern with other aspects of the operation of the wholesale market in Tasmania. Moreover, the market dominance of the FCAS market by Hydro Tasmania is replicated in the structure of the wholesale energy market.

Given the recent history of examination of market power events by local regulators in Tasmania, and their ultimate findings, Aurora supports the AEMC continuing its review of the potential for the exercise of generator market power in the NEM, including in the Tasmanian context.