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Australian Energy Market Commission – review of energy market design in light of CPRS and MRET: 1st Interim report

This submission has been prepared by the Consumer Utilities Advocacy Centre Ltd (CUAC), an independent consumer advocacy organisation, established to ensure the interests of Victorian consumers, especially low-income, disadvantaged, rural, regional and indigenous consumers are effectively represented in the policy and regulatory debate on electricity, gas and water.

We thank the Australian Energy Market Commission (AEMC) for the opportunity to inform its work on energy market design through this and previous rounds of consultation conducted late 2008.

CUAC has actively worked to incorporate the insights and views of consumer advocates across Australia into this submission to better facilitate community consultation with the AEMC. The submission has been formally endorsed by the following organisations:

- Victorian Council of Social Service
- Australian Council of Social Service
- Consumer Action Law Centre
- Alternative Technology Association
- St Vincent de Paul Society
- Public Interest Advocacy Centre

CUAC has been actively engaged in this and other reform processes such as the AEMC review of demand side participation, development of the National Energy Customer Framework, Advanced Metering Infrastructure working groups, development of distribution network planning and connection arrangements and so on. This gives us a

broad perspective on how consumers are affected by reform processes, and how each reform process is necessarily interdependent on the other.

Executive Summary

We remain primarily concerned with the potential for competitive market discipline to be eroded or gamed at both wholesale and retail levels as the impact of the Carbon Pollution Reduction Scheme (CPRS) and the expanded Renewable Energy Target (RET), as well as other energy market shocks such as water availability, gas market constraints, financial market instability and weather volatility, impact upon energy market participants.

In its scoping paper, the AEMC noted one of the main outcomes of this review is to “identify the potential impacts on the energy markets with respect to achieving the market objectives of efficient, safe, secure and reliable energy supplies that are provided in the interests of consumers”. This outcome is closely tied to the National Electricity Objective (NEO) set out in the National Electricity Law (NEL).

The AEMC has championed competition as the primary mechanism by which the NEO is delivered. Despite repeated concerns being expressed by consumer groups and consultant reports to the AEMC about the potential for competition to be undermined at wholesale and/or retail levels, the AEMC has ignored this issue in its deliberations, and done so without rationale. It is essential to the integrity of the National Electricity Market (NEM) that it is designed to both actively avoid and manage any breakdown in competition.

In addition, the AEMC has not acknowledged or considered the impact of the consumer protection framework on the behaviour of energy market participants despite repeated concerns being expressed by consumer groups on this issue. Against a backdrop of wholesale price volatility and uncertainty, retail price deregulation in Victoria, impending retail price deregulation in South Australia and mounting pressure on retail price deregulation across other NEM regions, the potential for market consolidation and subsequent abuse of market power at the retail level will be ripe.

To ensure it meets its objectives, and the objectives of this review, we call on the AEMC to acknowledge the importance of the customer protection framework in ensuring the NEO is met, and we recommend the AEMC to consider the risk to effective competition posed by wholesale gas and electricity price uncertainty as part of this review.

Introduction and background to submission

While energy market developments are difficult to predict, we remain concerned that wholesale energy price volatility and uncertainty will work to create substantial barriers to entry in both generation and retail markets and that market conditions will favour increasing market consolidation. With increasing pressure for market consolidation, the effectiveness of competition in energy markets cannot simply be assumed.

For these reasons, an analysis of the adequacy of the consumer protection framework being developed as part of energy market reform, and the impact this could have on the ability of the market to work in the long term interests of consumers, is an essential component of this review. If energy market competition fails, customer protections become pivotal, in order to ensure the market works in the long term interests of consumers. Failure to consider this issue is particularly concerning given the emphasis the AEMC places in its 1st interim report on the need to remove price regulation and the essential role customer protections play in ensuring effective competition.

Customer protections help ensure effective competition by providing guidance, clarity and consistency to the behaviour of energy market participants. Customer protections are necessary to ensure that consumers in the market are informed, can easily compare price and non-price contract terms and conditions, and have confidence that information provided by the market is comprehensive and reliable.

The consumer protection framework in Victoria has also been critical in ensuring consumers are protected from price shock and/or income shock – unforeseen increases in energy costs and/or income that threaten the affordability of energy. Energy is an essential service which makes avoiding disconnection and/or payment difficulties critical to avoiding subsequent compounding social problems.

Should the new National Energy Customer Framework (NECF) fail to protect consumers from price or income shock, or fail to guide consistent and transparent behaviour by energy market participants, the energy market will have failed to deliver secure, reliable and efficient supply of energy in the long term interests of consumers.

Specifically, we believe that as part of this review, the AEMC must analyse the impact of possible market developments catalysed or accelerated by CPRS and RET including, but not limited to: market consolidation acceleration; retail price deregulation across the NEM; and installation of smart meters. Questions to address could include:

- What controls will be in place over critical peak pricing and tariff shapes to protect customers from vertically integrated retailers gaming the wholesale market to increase spot prices, and ultimately retail prices?
- How will elderly and other consumers vulnerable¹ to extreme temperatures be protected from peak prices or direct load control services?
- Will distribution businesses have confidence that tariff shapes are passed through by retailers to customers? What effect will this have on distribution companies' ability to manage network peaks? What affect will this have on network costs?
- What assistance will be offered consumers to help them compare increasingly complex offers and so reduce search/switch costs²?

¹People with multiple sclerosis, Parkinson's disease, scleroderma, quadriplegia, motor neuron disease, fibromyalgia, systemic lupus erythematosus and post-polio syndrome are all extremely vulnerable to heat stress – for an excellent overview of these issues go to <http://www.mssociety.org.au/live/documents/MS-Dcssn-Ppr-NSW-Medical-Cooling-Rbt-Aug-08.pdf>

More generally, the AEMC 1st interim report and reports provided by consultants, leaves us without confidence the AEMC is investigating the right, or complete set of issues in this review. We are concerned at the speculative nature of consultant reports and analysis³ and the lack of transparent process for how issues have been selected and prioritised, with many issues raised by consultants or stakeholder advisory group members ignored by the AEMC, with other issues elevated to high priority.

For instance, at a wholesale level, we note the risk of increased opportunities for abuse of market power caused by potential network congestion is repeatedly mentioned in the consultant report of MMA, the ROAM Consulting report highlights the risk of this at least in the short-term while emission prices are low (pg. 83) but less so in the long term, while Frontier Economics downplays this risk. Frontier suggests that because vertical integration and hedging through contracts are motivated by the same thing (i.e. reducing risk), there will be no greater incentive to vertically integrate. We believe this is erroneous – a hedge with a 3rd party can create winners and losers. An internal hedge creates a neutral outcome therefore is a more effective risk management approach, therefore more likely to occur when wholesale price uncertainty exists.

All three consultant reports appear to refer to the presence of ‘strategic bidding’, or some other comparable term, and the importance of its effect on market outcomes, however not all reports agree this will be exacerbated by CPRS and/or RET - given it is repeatedly mentioned as a major factor on market outcomes should be concern enough. The issues of increasing pressure to vertically integrate, lack of liquidity in wholesale contract markets and the potential this has to undermine competition has also been raised in stakeholder advisory committee meetings.

However, the AEMC has chosen not to include consideration of market power issues as part of this review, suggesting competition regulation is sufficient. However this ignores the reactive nature of regulation, and the potential benefits of market design limiting potential market power abuse in the first instance.

Reiterating our submission to the Review Scoping Paper we recommend the AEMC consider market consolidation and market power issues as part of this Review, the impact this could have on market performance and ways to ameliorate these risks. Given effective market performance in the interest of consumers relies on the presence of competition, we believe this is absolutely fundamental to this review.

² We note search costs often impede effective competition by providing disincentive to customers seeking out better deals – this makes consumers more reliant and dependant on aggressive marketing which is not conducive to effective consumer decision making

³ ROAM Consulting highlight that many market outcomes are highly sensitive to assumptions that are very difficult to predict such as future energy demand, emission permit prices, gas prices and the respective roles of gas and renewable generation in meeting new demand. However neither the AEMC or consultant reports appear to provide detailed results of sensitivity analysis conducted around these variables

We draw attention to pertinent MMA analysis on one potential opportunity for market power issues to manifest at the wholesale level in electricity markets (pg 67) which states:

“Whilst this (uneconomic supply bidding to squeeze out marginal generation) is covered under the Trade Practices Act, in practice it is difficult to prove in electricity markets operating under self-commitment and with multiple risks and constraints to manage.”

The analysis then suggests there may be a need for monitoring bid prices and comparing them to short run marginal costs to provide an early warning signal for this behaviour.

Lastly, it is worth noting that Frontier Economics and ROAM Consulting also appear to use contradictory arguments on the effect RET may have on price volatility and generation investment, with ROAM suggesting RET will decrease the incidence of high pool prices and so be a disincentive to building gas turbines, while Frontier suggest RET will increase price volatility which will act as a signal to investors to build gas turbines, which will then dampen volatility because of reduced opportunity for strategic bidding. We have seen no analysis to reconcile the competing views on this important matter.

Chapter 1 Summary – Convergence of Gas and electricity markets

Question A1.1

Do you agree that the convergence of gas and electricity markets is not a significant issue in the eastern states and therefore should not be progressed further under this Review? If not, what are your reasons for asking us to reconsidering this position?

We do not agree that the convergence of gas and electricity markets is not a significant issue. We believe that climate change policies including the CPRS and MRET will significantly increase demand for gas. Combined with projected international gas supply/demand conditions, we suggest the Review consider what effect abuse of market power in gas markets could have on energy market operation, and whether gas security management processes are sufficient to ensure the NEO is met.

We note the AEMC analysis points to the need for transparent market pricing as a signal of the value of gas scarcity, and seems to suggest this is sufficient to manage gas security by acting as a signal for investment. However transparent and accurate pricing does not mitigate gas security issues for consumers. The AEMC analysis seems to rely on an assumption that given the right price signal, alternatives to gas and/or gas curtailment will develop in an efficient and timely way – all driven by the price signal. We contend this assumption is ambitious and that price signals will be insufficient to mitigate gas security issues at least in the short term.

On potential for abuse of market power, we draw attention to MMA analysis which suggests that should gas congestion problems emerge (pg.7):

“There may be potential for participants that control gas supply, transportation, storage, and generation assets to directly influence market outcomes. The ability of smaller producers to access “common infrastructure” such as treatment plants, storage, compression and LNG plants may become increasingly important in order to maintain competition in the gas sector, and to ensure that efficient gas market outcomes are transferred to the electricity and energy retail markets”

Integrated gas and electricity system planning processes may need to be made more robust, particularly to accommodate a departure from traditional incremental growth assumptions towards new processes that can accommodate the large and coordinated infrastructure investments that could be needed to support shifts in generation centres to new regions having renewable generation resources and significant gas infrastructure.

System security requirements may be such as to require additional or new storage to be built, possibly with regulated pricing.”

The AEMC points out that the regulatory framework provides a safety net should a privately owned, unregulated pipeline owner withhold access in an uncompetitive manner. However, the safety net is reactive and cannot prevent uncompetitive behaviour in the first instance. We reiterate our view that energy markets (as designed in the NEM and NGM) rely on effective competition to promote commercial discipline to energy market participants. Any breakdown in competition, particularly at the wholesale supply end, represents significant risks to proper functioning of the market.

We believe that given the apparent heightened potential for market power abuse, consideration of how to amend market design to anticipate and prevent abuse of market power should be central to this AEMC Review. Reliance on a reactive safety net is insufficient.

Chapter 2 Summary – Generation Capacity in the Short Term

Question A2.2

Do you agree that the ability for NEMMCO to manage actual or anticipated transitory shortfalls of capacity is a significant issue that should be progressed further under this Review?

Based on consultant reports this appears to be a significant issue, not just for managing short term generation capacity, but potentially for ensuring the electricity grid operates efficiently and reliably with high levels of intermittent generation. This importance of this issue should also help guide AEMC work on barriers to demand side participation.

In analysing this issue, the AEMC should consider the process for retiring significant old generation plant, for commissioning new plant, and how the processes are coordinated to ensure system reliability is met. We are not aware of the deregulated market being

through this process before, making this a critical ‘stress point’ to be tested by the AEMC.

Consideration may also need to be given to how frequency control is managed on the network with a greater diversity of generation types and locations having the potential to challenge frequency management procedures.

Question A2.3

Are additional mechanisms required to complement the Reliability and Emergency Reserve Trader (RERT) and NEMMCO’s directions powers, and what characteristics should such mechanisms have?

We believe the fundamental issue to be considered here is whether processes for signaling new investment are sufficient to ensure that investment arrives in time and in a way which aligns with retirement of major plant if necessary. RERT is a reactionary tool – the AEMC should address whether additional mechanisms required to complement the Statement of Opportunities report.

We note many stakeholders have highlighted the recent history of private investors delivering on new investment required in the NEM, however it must be acknowledged investment conditions for the decade following the mid 1990’s have been relatively benign.

The CPRS and RET policy settings present challenges to investors in an otherwise stable environment and it may be reasonable to assume energy markets can handle this challenge. However the current (and likely continuing) crisis in financial markets means that investors are operating in fundamentally different conditions. Combine these uncertainties with the potential for significant programs to boost energy efficiency, demand management, distributed generation, the potential for gas market constraints, and increased weather volatility impacting on energy supply/demand dynamics, it is a high risk assumption to suggest the market will deliver because it has delivered in the past.

We believe the AEMC should consider the above, in combination with deliberations on the merit of measures complementary to RERT to ensure timely new investment in generation.

Question A2.4

Do you have any views on the detailed design and implementation of additional mechanisms [to the RERT]?

One of the benefits of an active and effective demand side in the NEM is that, it can quickly and efficiently provide significant capacity to the NEM through either taking discretionary load off the network or providing generation to the network and/or users in the network.

We note that work on developing an active demand side in the NEM has been ongoing for a long period of time with limited noticeable difference to the role of demand side to date. We suggest that the AEMC review of demand side participation is critical to ensuring an effective demand side in the NEM and that this matter should be dealt with in that review. Any further delays to resolving demand side participation in the NEM risk significantly compromising efficient market outcomes.

One potential mechanism which could be considered as part of the DSP review would be to require NEMMCO and/or network businesses to find xMW of discretionary load that they can turn off on request in times of generation shortfall – essentially to create a target for identifying discretionary load that can be taken off the network at peak times or in emergency situations. The target could be designed to build resilience against the most probable and/or high impact supply failures, and most likely be expressed as some percentage of total peak demand on the network of a particular business.

Chapter 3 Summary – Investing to meet reliability with increased use of renewables

Question A3.1

Do you agree that the existing framework based on an energy-only market design with supporting financial contracting is capable of delivering efficient and timely new investment, including fast response capacity to manage fluctuations in outputs resulting from larger volumes of intermittent wind generation? If not, what are your reasons for reconsidering this position?

Based on consultant reports, it appears likely that investment in new fast response generation will develop in time, however additional large scale generation is not the only way to ensure large amounts of intermittent generation can be managed in the NEM. Demand side response can also help with integrating large scale intermittent generation.

However we also note observations made by ROAM Consulting suggesting that if gas prices rise sufficiently, investment signals for new gas generation may be undermined and the AEMC and NEMMCO would need to find alternative avenues to ensure system security (pg 108).

Given the apparent high degree of uncertainty around future gas prices, we consider it would be prudent for the AEMC to take a proactive risk management approach – i.e. to ensure that should any forecast investment in new gas generation not materialise, alternative measures exist to ensure system security. Any major failure in energy system security would weigh heavily on energy market participants and erode confidence in the NEM.

Question A3.2

Do you agree that the processes supporting the ongoing maintenance of this framework in respect of review and periodic amendment to the market settings, including the maximum market price, are robust? If not, what are your reasons for reconsidering this position?

Again, we reiterate our observation that the AEMC should satisfy itself that in the event of price signals not resulting in sufficient spare generation capacity, alternative measures are in place to ensure system security. We do not believe it is sufficient to rely on price signals, such as VOLL, alone.

Chapter Summary 4 – system operation and intermittent generation

Question A4.1

Do you agree that operation of the power system with increased intermittent generation is not a significant issue and therefore should not be progressed further under this Review? If not, what are your reasons for reconsidering this position?

Provided the investment in generation capacity with fast response times, and/or the right frameworks for DSP are in place, system operation with increased intermittent generation should be manageable. We note ROAM Consulting suggests the viability of fast response gas turbines is likely to be contingent on improvements in wind forecasting being made by NEMMCO (pg. 100).

Chapter Summary 5 connecting new generators to energy networks

Question A5.1

Do you agree that the connection of new generators to energy networks is a significant issue that should be further progressed under this Review? If not, what are your reasons for reconsidering this position?

We believe the efficient connection of new generators to the network is a significant issue. We note the AEMC will be conducting a parallel review specifically into the national framework for electricity distribution network planning and expansion and is continuing its demand side participation review – how to ensure efficient connection of new generation at a distribution and transmission level should be a high priority in these reviews.

With relevance to this review and parallel work being done by the AEMC, we draw attention to MMA analysis:

“Better information on the cost, value, timing and location of transmission projects may be required to support a more active market in demand-side response and in embedded generation resources. Whereas the value of participation by distributed resources may markedly increase under CPRS and RET, there is currently minimal public information to assist planning of these resources by private investors. The information is largely held by TNSPs and DNSPs and is not published in a form that is useful for planning the aggregation of distributed resources (useful for network planning and connection arrangements). Rather it is provided on a project by project basis with lead times that are insufficient for long-term planning.”

We remain concerned that consumers will be asked to underwrite private investment risk, either through the tax base or through regulated returns on assets, of new generation investment. We note the AEMC's comment that:

“If significant assets did become redundant and the TNSP did not seek to manage the risk, like seeking to negotiate a lower cost for the network user, then NER clause S5.2.3 allows the AER to remove assets from the regulated asset base. This reduces the risk of end use consumers having to pay to maintain redundant assets.”

However Garnaut and others suggest Government funding may/should be used to build transmission to new locations where renewables can connect – this would be a cost to consumers through the tax base. We believe this would increase the risk of politically motivated investment which could undermine the efficiency of the NEM. To the extent it is possible, we recommend the AEMC ensure transmission investments are not funded through direct Government expenditure and that transmission planning remain a market function so that network expansions are made with commercial discipline.

Question A5.2

Would any of the models identified in this chapter ensure the more efficient delivery of network connection services?

Option 3 appears to be the option most likely to deliver fair and equitable outcomes for consumers as well as market discipline for those seeking to connect new generation assets to the network. We would welcome further discussion of how this would work in practice and suggest the AEMC review international models for managing this issue.

How should the risks of connection be most appropriately spread across new connection parties, network businesses and end use consumers? How do the connection charges change for connecting new generation plant and what benefits may arise? How do the costs for end use customers change and what benefits may arise?

Option 3 seems to spread the risk of connection across parties better than any other option. The cost of connecting ultimately needs to be spread across new generators and consumers, with generators facing sufficient risk to ensure they generate efficiently, but not so much risk as to make connection unviable. It is appropriate consumers should be protected by an economic test done by an independent body, such as the national transmission planner. This should encourage the most efficient connection of new generation.

We believe it is essential that whatever model for connection is adopted, it better facilitates connection of any generator type and that the process is not tailored to suit generators of particular type/s.

Question A5.3

Are there any other potential models that we should consider to address this issue?

We would welcome more detailed discussion of how option 3 could work in practice.

Chapter Summary 6 – augmenting networks and managing congestion

Question A6.1

Do you agree that the issue of network congestion and related costs requires further examination in this Review to determine its materiality? This includes considering whether the existing frameworks provide signals that are clear enough and strong enough in the new environment where congestion may be more material. If not, what are your reasons for reconsidering this position?

Yes, network congestion issues should be progressed as part of this review, particularly in light of its potential to encourage ‘strategic bidding’ i.e. abuse of market power amongst generators.

Again, we note the importance an active demand side could play in efficiently managing network congestion across the NEM and encourage the AEMC to consider this as part of its review of Demand Side Participation.

Chapter Summary - Retailing

Question A7.1

Do you agree that the current inflexibility in the retail price regulatory arrangements is a significant issue that should be progressed further under this Review? If not, what are your reasons for this position?

We believe that if the matter of retail price regulation is considered as part of this review it should be coupled with a review of the adequacy of the customer protection framework and it should be made explicit that removal of retail price regulation will remain subject to a full review of competition.

We contend the negotiated retail price path is sufficiently flexible to deal with price fluctuations caused by CPRS and MRET and that price regulation is not incompatible with competition⁴. As policies take shape, their effect on prices are much more likely to be understood or predicted with some degree of confidence. The AEMC provides no credible evidence to suggest the negotiated price path cannot deal with costs imposed by CPRS and/or the expanded RET, it merely states this is a risk.

The 1st interim report suggests in relation to cost pass through of CPRS that (pg 54):

“Households only see price increases, however, if regulated tariffs are amended to provide for the cost pass through. At a minimum, delays in adjusting the

⁴ We note Victoria was deemed to have one of the most competitive retail markets in the world at the same time it exercised price regulation

regulated tariffs may mean that retailers are under-recovering costs by as much as 18 per cent for electricity customers and 12 per cent for gas customers. This is an unsustainable situation for retail businesses.”

On page 56, the AEMC then details an MCE directive that allowances be made for the pass through of carbon costs to consumers. It is absurd to even suggest that retailers may under-recover by as much as 18% for electricity and 12% for gas due to CPRS when there is a directive from the highest energy policy authority in the country to require carbon costs be passed through to consumers.

The AEMC provides no comment or analyses on the likely cost of RET to retailers, and only states that the ability to pass through Renewable Energy Certificate (REC) costs is retained through price determinations. Therefore, we find no reason presented by the AEMC for how price deregulation can be justified due to the costs of CPRS and/or RET.

With regard to wholesale energy costs, the primary risk the AEMC can legitimately concern itself with is the degree to which retailers can source hedge contracts, or vertically integrate, to manage the risk of wholesale price volatility and increases caused by policy uncertainty and/or other factors such as financial market issues.

However, we suggest that the negotiated price path may not be sufficiently flexible to deal with unexpected or unforeseeable climatic conditions such as water availability and temperatures which have recently affected supply capacity and demand respectively across the NEM. These conditions appear to have caught energy market participants by surprise.

We believe that measures could be designed and implemented so that the impact of unexpected price shocks on retailers and consumers can be managed. Conversely, unexpected drops in energy costs could also be passed through to consumers as savings. In this way, the negotiated price path could help retain some price stability – and hence reduce the risk of price shock – while price shocks could be passed through in a smooth fashion. A well designed mechanism would offer more protection to retailers and customers alike, while maintaining commercial discipline on retailers to properly hedge their risk.

Managing the risk of price volatility should not be left to consumers who, of all energy market participants, are least able to forecast energy market conditions and manage risk. Without a full review of competition, consumers in some states may be doubly at risk through compounding problems of a lack of genuine competition in their market and energy price volatility.

Significantly, we note MMA analysis (pg 8) which highlights increasing pressure on energy market consolidation and so implicitly threatens to effective competition:

- *“Greater integration into generation could occur under some circumstances, in part to overcome disturbances affecting the contracts*

market, and to benefit from, or to hedge, wholesale market price volatility that could otherwise squeeze the retail function.

- *Large national, dual fuel and vertically integrated utilities could increase market share if financial market instruments do not evolve to handle the uncertainties.*
- *Some segments of the retail market may face limited competition, requiring more robust market monitoring and market power mitigation arrangements”*

The MMA analysis (pg 66) goes on to suggest that further review of issues around wholesale market competition and its effect on retail market competition should be undertaken. Specifically, the paper suggests:

“If adverse outcomes arise from companies seeking to preserve their market solvency through lessening competition, then the competitive principle of the energy market frameworks could break down.

Competition can best be maintained by ensuring that reserve plant can secure revenue commensurate with economic value and that the declining performance of the retiring high emission generation is recognised in defining targeted reserve levels and securing additional reserve capacity from the supply and demand sides in a timely manner. Our discussions in this report concerning reliability and reserve capacity management suggest areas of review to help to maintain competition in wholesale energy which will feed through the retail supply chain.

This issue does not present an immediate concern for the energy market frameworks, but it does warrant further analysis. Scenario based conduct and impact modelling is recommended at a unit and portfolio level, with analysis around critical retirement thresholds for significant coal units, and with some sensitivity to investment lags. The analysis should seek to identify potential pivotal suppliers in the various scenarios, and provide a basis for the advanced development of market power mitigation arrangement if the risks are deemed material.

At least during the period when the CPRS is being implemented, more robust market monitoring systems may be required, including functionality for:

- *The physical audit of electric facilities to verify unit operations and validate forecast levels of reliability that are used in planning required capacity reserve levels.*
- *Routine conduct and impact testing for physical and economic withholding behaviour.*
- *Participant portfolio analysis to identify and monitor pivotal suppliers.*
- *Explicit bidding of start-up and shut-down costs, thereby removing these components from energy bids. This may make costs more transparent.*
- *The development of stand-by market power mitigation arrangements.*

The industry may benefit from the development of a suite of stand-by market power mitigation arrangements, such as arrangements for the setting of default bids and sanctions that are linked to the market impacts of inappropriate conduct. This regulatory functionality could be introduced to address market concerns as they develop, and may in themselves constrain behaviour in advance of problems developing.”

The AEMC appears to have rejected this advice and does not appear to provide any rationale for its exclusion.

Question A7.2

Do you agree that the limitations with current RoLR arrangements are a significant issue that should be progressed further under this Review? If not, what are your reasons for this position?

We note our understanding that RoLR arrangements are currently the subject of assessment by MCE in the context of work towards the NECF. MCE had proposed (in February of last year) that AEMC would be charged with the task of reviewing RoLR arrangements following some initial work by a consultant but, as we understand current plans, this is no longer the case. Work to finalise policy for RoLR and develop drafting instructions for legislation and rules will be retained to MCE, MCE SCO and the Retail Policy Working Group.

It would seem to be a duplication of work for the AEMC to [re]consider issues associated with current and proposed ROLR arrangements when this work is being progressed through other market reform processes. It would seem likely that AEMC views about current and future RoLR arrangements would be welcome and appropriate contributions to the work in train under the aegis of the NECF. Other parties to this Review might similarly express views about RoLR arrangements directly to the MCE.

In the Chapter Summary for Retailing (Issue A7) the AEMC notes its concern that “there is a risk if these reforms [to retail price regulation and RoLR arrangements] are not progressed and implemented in line with the introduction of the CPRS and expanded RET”. We are considerably more concerned that processes underway towards the introduction of the CPRS and expanded RET are proceeding in the absence of a proper, comprehensive and consistent regulatory framework governing the interests of energy customers. Finalisation of the NECF in its entirety is a matter of great urgency.

We are concerned that the AEMC appears to have taken a selective approach to the issues it deems significant, with a particular focus on retail price flexibility and the need to review ROLR arrangements. Without considering broader market developments that could work to undermine competition, any analysis of price regulation and/or ROLR will be inadequate.

While there may be legitimate concerns about retailer viability, we believe commercial discipline is essential to the proper functioning of energy markets and that at a time of

market uncertainty, undermining commercial discipline would be detrimental to market outcomes. Therefore, the AEMC must carefully consider the approach it takes to ROLR, in particular the risk that ROLR arrangements could undermine a retailer's incentive to efficiently manage its risk (i.e. by offering a profitable market exit). If ROLR arrangements make it easy for marginal retailers to exit the market, momentum behind market consolidation will accelerate. If coupled with price deregulation, incumbents will have unprecedented ability to control retail prices.

We note MMA analysis (pg. 8) which predicts market power issues, increasing market consolidation and the potential need for increased demand response alongside potential challenges for ROLR arrangements:

“The retail market will accumulate upstream cost pressures and market volatility, and may also be affected by contradictory regulatory provisions at the state level, impacting cost pass through and customer protection obligations. In particular:

- We anticipate an increase in wholesale market prices and settlements volatility in both gas and electricity. Volatility could increase through inconsistent patterns of retirement and new investment, exercise of market power, and by an incompatibility in the spot market design logic with the changed operational and contractual realities affecting participants. This could disturb the efficient function of the contract markets, and heighten prudential, counter-party and credit risks within the organised and bilateral markets, reducing hedging opportunities for retailers.*
- It may become politically unacceptable in some states for small mass-market customers to experience large price increases. Price controls and more onerous customer protection arrangements may result. Small retailers with a customer portfolio bias towards this segment may experience difficulty, presenting implications for retailer of last resort arrangements, and causing some industry consolidation.*
- Demand management may become a significant transition strategy to manage energy scarcity in a scenario of investment delay and early coal unit retirement. Large controllable loads may therefore benefit with increased service innovation and price competition.*
- We have identified incentives towards horizontal integration, including dual fuel, appliance sales and installation and other bundled ancillary offers to cross-subsidise low margins in the mass market, and to seek advantage from potential government programs relating to energy efficiency rebates and incentives.”*

Given the interdependency of these issues, we believe it is prudent and necessary for the AEMC to consider market power issues alongside any further consideration of ROLR and/or price deregulation.

Chapter Summary – financing new energy investment

Question A8.1

Do you agree that the current energy market frameworks do not impede the efficient financing of the significant increase in investment implied by CPRS and expanded national RET? If not, what are your reasons for this position?

We agree energy market frameworks do not necessarily impede the efficient financing of increased investment implied by CPRS and RET. However we reiterate the need to ensure energy market frameworks are capable of managing the timing of new investment with the retirement of significant generation assets. We also note that efficient financing will be in part dependant on policy certainty, as well as certainty over arrangements for connecting new generation.

Ongoing Consultation

As discussed at the last stakeholder meeting, CUAC supports establishing sub groups to examine specific issues identified in the 1st interim report in more detail. We recommend that all papers relevant to consultation be circulated at least one week prior to meetings to allow time for review and consideration. To ensure transparency, we recommend all sub groups report the detail of their discussions back to the main stakeholder advisory group.

Lastly, we encourage the AEMC to take measures to ensure public consultations allow genuine public participation and input to the issues considered as part of this review. We note the existing stakeholder advisory committee primarily constitutes industry representatives, and the importance of balancing those interests against those of the community to ensure the NEO is met.

If you have any further queries please contact Tosh Szatow, Policy Officer on (03) 9639 7600.

Yours sincerely

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