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Merits review - an inevitable step in distribution pricing determinations?

Consumer Action and the Consumer Utilities Advocacy Centre have released a report which shows electricity distribution companies are routinely challenging pricing determinations made by the Australian Energy Regulator (AER) at a rate that suggests the regulatory framework actually incentivises businesses to appeal. This is evidenced by the number of appeals (five out of the six decisions the AER has made since 2008) and the success achieved in using it to increase their profit margins.

Distribution charges make up about 40% of consumers' bills. The charges are assessed and set by the AER, following a detailed price review process. While that process remains reliant on information provided by the distribution businesses themselves, it does allow input from a wide range of stakeholders. The appeals process on the other hand is heavily weighted in favour of the distribution businesses and there are huge practical and legal barriers to effective consumer participation in that process.

At present distributors have a legal right to challenge the merits of the AER's pricing determinations and have little to lose in doing so. As it stands, the process allows distributors to only challenge the parts of an AER decision they think they can win, and the costs of doing so are ultimately paid by consumers.

These businesses are natural monopolies as it makes no sense for multiple businesses to provide the poles and wires to a particular region or property. Thus they face no competition and the framework therefore relies on the regulator's ability to determine a reasonable but fair rate of return. Unfortunately, with the businesses in control of the information and having ability to readily appeal the AER's decision, the law does not currently ensure consumer interests are protected.

When all five Victorian distributors challenged the AER's proposed network pricing for 2011 – 2015, Consumer Action and CUAC attempted to represent the interests of consumers at the resulting tribunal hearing, but received legal advice that, in effect, they were not able to do so. Essentially, the barriers against consumer intervention were impossibly high and as a result, the distributors get to plead their case without little scrutiny or voices of dissent. Whilst the AER is a party to the appeal it is unlikely they would appeal aspects of their own decision! While the law provides a theoretical right for consumers to be there, lack of access to information, resources and technical expertise means that in practice that right cannot be exercised.

There is an alternative - judicial or administrative review. This is the review process that applies to most other decisions by government departments or authorities. Further the grounds on which review can be sought better reflect the extensive and multi-stakeholder process undertaken by the AER in reaching its decision.

Consumer Action and CUAC believe there is an urgent need to reform the legislation which sets out the basis for appeal. A review was promised upon enactment of the current provisions and would provide a genuine and rare opportunity to limit self-interested appeals by the businesses and to strengthen the AER's powers, to create a system in which all sides of the debate are represented.

Electricity is an essential item so cost increases have a profound effect on every member of our community. Consumer protection against price gouging from distributors needs to be guaranteed.

A copy of the report "Barriers to fair network prices, - An analysis of consumer participation in the merits review of AER EDPR determinations" can be found [here](#).

We welcome feedback on the information provided in *On the Wire*. Further, we encourage you to forward the newsletter throughout your networks. Production of *On the Wire* is funded by the [Consumer Advocacy Panel](#). To subscribe to *On the Wire*, please email info@consumeraction.org.au with the words "Subscribe to On the Wire" in the subject line. The next edition of *On the Wire* is scheduled for release at the end of December 2011.

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1. Regulatory developments

1.1 Ministerial Council on Energy (soon to be Standing Council on Energy and Resources)

- **MCE/SCER transition delays**

The proposed transition from the Ministerial Council on Energy (MCE) and the Ministerial Council on Mineral and Petroleum Resources (MCMPR) to the Standing Council on Energy and Resources (SCER) has been delayed from its expected, official start date of 1 July 2011. The Council of Australian Governments (COAG)—following its recommendation in February 2011 to rationalise existing Ministerial Councils into fewer councils—is still to make a formal decision on a new council system.

As such, until the Terms of Reference of the SCER have been agreed to by COAG (expected to occur in this quarter), the roles of the existing Councils will continue.

More information can be found [here](#).

- **Separation of Generation and Transmission (SCO Bulletin, No. 196)**

The MCE Standing Committee of Officials (SCO) has released a [consultation regulation impact statement \(C-RIS\)](#) in relation to possible anti-competitive behaviours associated with the co-ownership of transmission and generation businesses within the National Energy Market (NEM)—primarily to determine the potential risks of proceeding down this path, including those associated with co-ownership arrangements in the NEM, such as possible market failure and reduced generator competition.

The integration of competitive and monopoly sectors plays with the fundamental issue of market structure and, in the long term interests of consumers, a case clearly needs to be made before any such decision. If our experience from the vertical integration of generation and retail is anything to go by, it is difficult to see how that case could be made, or why it is necessary. It also begs the questions; If we were going to allow this, why disaggregate in the first place (at huge public expense)? And will there be pressure to disaggregate again down the track?

- **Gas Appliances (Carbon Monoxide) Safety Strategy (SCO Bulletin No. 195)**

The MCE released a draft of the Gas Appliances (Carbon Monoxide) Safety Strategy which provides a detailed technical discussion and examines the causes of CO accumulation to

hazardous levels, and presents the merits of potential options to mitigate the risk of CO poisoning in residences and recreational vehicles. Submissions closed on the 19th of August. More information on the draft strategy can be found [here](#).

- **Mandatory disclosure of residential building energy, greenhouse and water performance—Consultation Regulation Impact Statement (SCO Bulletin No. 194)**

In July 2009, as part of the National Strategy on Energy Efficiency (NSEE), COAG agreed to phase in mandatory disclosure of residential building energy, greenhouse and water performance at the time of sale or lease, starting with energy efficiency.

A [Consultation RIS](#) was released in July 2011 and considers several options to reduce greenhouse gas emissions, by addressing information shortfalls and the uneven distribution of information in the residential housing market that prevent efficient investment in energy and water efficiency.

It assesses a range of regulatory options for the disclosure of energy, greenhouse and water information, such as full thermal assessment; simplified thermal assessment; online self-assessment; checklist assessment; mandatory rating with an opt-out feature; or a non-Regulatory or voluntary uptake.

It also considers the options of disclosure at point of sale only, versus point of sale and lease.

The RIS places additional focus on [remote housing](#), raising the possibility of an exemption from the mandatory disclosure scheme, and sought recommendations on how [social housing](#) needs might be met.

Public consultation meetings were held throughout August 2011, submissions closed 12 September 2011. A Decision RIS will be prepared and approved by the Office of Best Practice Regulation and will then be considered by the MCE/SCER.

The measure will be implemented through state and territory legislation and, as such, the date for commencement is a matter for those governments to decide. More information can be found [here](#).

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1.2 Energy White Paper update

Extensive work on drafting the Energy White Paper is underway in Canberra, with the goal of releasing it for public consultation at the end of the year.

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1.3 Smart meters / Smart Grids

National Smart Meter Program (NSMP)

National Energy Industry and Consumer Forum

Following the completion of the NSMP's National Stakeholder Steering Committee (NSSC) role in June 2011, the responsibility for the NSMP program transitioned to the Australian Energy Market Operator (AEMO). While there are subcommittees and workgroups under the AEMO arrangement, they continue to be technical, and have no direct consumer representation.

However, the group, previously known as the NSSC, has since evolved into a network now known as the National Energy Industry and Consumer forum (NEICF), comprising largely all those representatives previously on the NSSC, with the added bonus of more consumer representation. At this stage, while not formally recognised by the government or AEMO as a body that feeds into the ongoing NSMP program, this group largely comprises those affected by the ongoing rollout of smart meters (and associated networks).

On Wednesday 21st of September, the NEICF convened a workshop on the key issues they see in the ongoing rollout of smart meters, "How do we make energy markets smarter". It was attended by representatives from distribution businesses, retail businesses, consumer organisations, third parties and government with the goal of assessing where we need to get to and how to get there in the short and long term.

While consumer interests in relation to smart meters were raised consistently throughout the workshop, predominantly by consumer representatives, as they have been for the past five years, there is still a long way to go before the businesses, in their role as providers of an essential service, fully come to terms with their obligations to the entire consumer base, rather than continuing to solely prioritise their own business interests (such as access and contestability) and those of their shareholders. The NEICF will develop a next steps platform of recommendations to AEMO and the government.

Victorian Smart Meter Rollout

The Victorian government is still to make an announcement on the future of the smart meter rollout in Victoria. After almost twelve months in office and an extensive review of the costs and benefits, the legal and regulatory framework and the canvassing of views from a significant number of stakeholders—there is still no official word as to the rollout's future.

In the meantime, and most importantly, consumers remain in the dark about what smart meters actually do, and what that means to them while continuing to pay for the rollout. Consumer uncertainty continues to rise.

Smart Grids, Smart Cities

AusGrid (previously Energy Australia) recently held a symposium to promote learnings from its smart grid project under the Australian Government's [Smart Grid, Smart Cities project](#). The forum, as well as providing an insight into the AusGrid project, also involved presentations from a range of members from the international utilities working group such as Kansai Power, China Light and Power, Shanghai Municipal Electric Power Company, and Guangdong Power.

What became apparent throughout the symposium was that not only do Australian companies have little to no understanding of the demand side's interaction with smart grids, but neither do those international counterparts also trialing or rolling out smart grids. When asked how one company planned to engage with consumers on the issue, the response; 'one at a time', demonstrated the lack of thought on the issue.

Faced with already complex energy markets combined with the introduction of smart grid technology, consideration of consumer needs is barely starting at a time when the businesses are so far down the track of providing the technology. It seems that the deal for consumers is effectively done.

It is essential that considerable work is undertaken to understand the experience of consumers currently in the marketplace and to identify what consumers need and want, and particularly the barriers consumers may face in understanding and participating in smarter networks.

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1.4 National Energy Customer Framework (NECF)

Work continues to progress in each jurisdiction with the goal of transitioning to the national laws in July 2012. Each jurisdiction is yet to finalise its transitional legislation and confirm that it will actually make the transition. The AER continues to work under the premise that it will be assuming regulatory responsibility for one or all jurisdictions on 1 July 2012.

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1.5 Australian Energy Regulator (AER)

Retail

Retail Pricing information guidelines

AER has released its [Retail Pricing Information Guideline](#), as required under the National Energy Retail Law, in relation to mandating the way retailers present their pricing information to customers. The guideline applies to energy retailers and will take effect when the Retail Law is expected to commence on 1 July 2012.

The guideline includes obligations for retailers to produce Energy Price Fact Sheets for each generally available offer detailing an overview of offers available, and details of price, fees, contract length and discounts.

We note that Ofgem, the energy regulator in the UK, has recently initiated a campaign to [simplify energy tariffs](#) through a unit pricing approach in an effort to promote competition between suppliers and support innovation and engagement of consumers.

Retailer authorisation guideline

The AER has released its [retail authorisation guideline](#) as required under section 117 of the National Energy Retail Law. The guideline relates to the AER's responsibilities for issuing and revoking retailer authorisations and has been developed to assist authorisation applicants to understand the process for obtaining energy retailer authorizations. It also covers the transfer, surrender or revocation of retailer authorisations.

The transition of existing retailers holding a state or territory retail licence will be determined by jurisdictions and implemented through application legislation, and any retailer that is granted a jurisdictional licence after 12 April 2011 who wishes to retail energy beyond 1 July 2012 will need to apply to the AER for a national retailer authorisation (or exemption).

The AER will start accepting applications for authorisation from 3 October 2011.

Price Comparator Website

Under the proposed National Energy Retail Law the AER must develop and operate an online price comparator to assist small customers access all offers available to them.

The AER has undertaken consultation including an [issues paper](#) on the price comparator website. Submissions to the Issues Paper closed 26 August 2011.

The [ACCC has recently announced](#) that it is going to take a close look at the marketing practices of energy businesses and energy switching sites, and their obligations under the Australian consumer law. This approach, combined with an effective price

comparator tool by the AER, should go some way to providing consumers with more confidence in the information available in the market.

Distribution

Merits review of gas access arrangement decisions by the Australian Competition Tribunal in respect of the QLD and SA gas distribution networks

The AER decision in relation to access arrangements for Envestra Limited's QLD and SA gas distribution networks and APT Allgas' gas distribution network in QLD is being appealed in the Australian Competition Tribunal.

Envestra and APT Allgas are seeking a review on matters including the methodology and estimation used to determine the debt risk premium, while Envestra alone is appealing the AER's decision on the estimation of the market risk premium and the estimation of the forecast volume of unaccounted for gas.

Applications for leave to intervene closed on 19 August 2011.

AER releases draft determination on Victorian advanced metering (smart meter) infrastructure roll-out 2012-2015

The AER released its Advanced Metering Infrastructure (AMI) [draft determination](#), in relation to CitiPower, Jemena, Powercor, SP AusNet and United Energy Distribution's AMI budgets and charges for 2012-15.

The draft decision highlighted that the Victorian DNSPs had not substantiated their proposed total budget for this period of \$1.24 billion. Instead, the AER considered a total budget of around \$760 million would more appropriately meet the tests in the Victorian Order in Council.

Submissions to the draft decision closed on 9 September 2011.

For more information on what the AER is up to, click [here](#).

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1.6 Australian Energy Market Commission

Power of Choice - Stage 3 DSP Review

In March 2011, the MCE directed the AEMC to undertake another review into Demand Side Participation (DSP) in the National Electricity Market (Stage 3 DSP Review), labeled as the [Power of Choice](#). The review seeks to identify further market and regulatory arrangements that may enable participation, both supply side and demand side, to achieve an economically efficient demand/supply balance in the electricity market, with a particular focus on:

- market frameworks to maximise value to consumers from services enabled by new technologies, such as smart grids;
- effectiveness of regulatory arrangements for energy efficiency; and
- efficient operation of price signals.

With approximately 40 responses from stakeholders the review appears to have generated a lot of interest. Unfortunately, grasping the complex issues involved is not aided by confusing terminology. The term 'demand side participation' is generally used to refer to consumer participation in markets generally, with the term 'demand side management' used to refer more specifically to consumer management of their electricity consumption. However, the AEMC paper appears to use the former term to refer to the latter concept.

Following a review of all stakeholder input, a directions paper will be published in November 2011 which will determine the suite of market conditions required across the supply chain and canvass the possible market and regulatory arrangements needed to promote more efficient electricity use.

Consumer Action's submission to the Commission raised a number of concerns, specifically that the Commission needed to first seek to understand the demand side more comprehensively before determining their ability to participate in demand management. This followed from the Commission's framing of the Power of Choice, which was based on the key assumption that "consumers will always make the best decision from their viewpoint, based on the prices they face, the technology and equipment they have access to, the information they have and their individual transaction costs". An assumption that simply can not stand up in the face of broader consumer policy and behavioural economics.

As the AEMC increasingly takes on responsibilities in the retail market, and in light of its obligations under the NEO, a more sophisticated understanding of the demand side of the NEM is essential to ensuring that competition and fairness in the markets can be achieved, and that the diversity of the demand side is adequately represented in the Commission's work, particularly in the case of DSP3.

Energy Market Arrangements for Electric and Natural Gas Vehicles

The Commission published an Approach Paper in relation to the Ministerial Council on Energy's (MCE) Request for Advice regarding Energy Market Arrangements for Electric Vehicles (EVs) and Natural Gas Vehicles (NGVs).

The MCE has requested the Commission investigate the costs and benefits of EVs and NGVs for the energy markets and to identify the arrangements necessary within the energy markets to enable uptake of these vehicles—in the context of attempting to address climate change and reduce greenhouse gas emissions.

It is increasingly likely that EVs and NGVs will play a more prominent role in Australia's transport mix, due to the combined economic benefits of fast paced technological developments and the increase in the price of conventional fuel substitutes. Further, there is an international movement focused on the development of low emissions vehicles.

Submissions on the Approach Paper are due by 27 October and the Commission is due to provide its advice to the MCE by mid-2012.

Further information can be found [here](#).

Rule change proposals

A range of rule change proposals have been initiated or are ongoing:

- The *Reliability Panel* submitted the Rule change request seeking to postpone the expiry of the Reliability and Emergency Reserve Trader by one year, from 30 June 2012 to 30 June 2013 as a transitional measure and allow the RERT to expire from the Rules on 30 June 2013. It also seeks to remove the requirement for a Reliability Panel initiated review of the RERT mechanism from the Rules. Submissions are due by 13 October 2011.
- The *Major Energy Users* submitted a Rule change request regarding the potential exercise of market power by generators in the NEM, which focused on the issue that during periods of high demand, some large generators have the ability and incentive to exercise market power to increase the wholesale electricity spot price. A public forum will be held in Adelaide on 12 October 2011 in relation to this rule change request and

submissions close on 17 November 2011. See also an MEU summary on this issue in section [2.2](#).

- The AER has submitted its rule change proposal to the AEMC with the changes focused on Chapters 6/6A of the National Electricity Rules and Chapter 9 of the National Gas Rules. Largely the proposed changes are to
 - amend the process for estimating how much electricity distribution businesses need to spend in order to provide a safe and reliable electricity supply
 - reform the way in which the returns that electricity and gas network businesses may earn on their assets is determined.

The AER is also proposing improvements to the process for making decisions, making it easier for interested parties to participate in the process. More information can be found [here](#).

More rule change proposals can be found [here](#).

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2. Consumer advocacy

Every issue, *On the Wire* includes articles by other consumer and community organisations. We welcome contributions. If you would like to submit an article for the next edition of *On the Wire*, please contact us at info@consumeraction.org.au with "On the Wire" in the subject line.

The following articles are produced by organisations other than Consumer Action Law Centre and do not necessarily represent the views of Consumer Action.

2.1 *The Carbon Tax: briefing note, Gavin Dufty, Manager, Policy and Research, St Vincent de Paul Society Victoria*

This paper seeks to analyse the geospatial impact on domestic energy bills of the proposed carbon tax at \$23 per tonne. This assessment will provide insights into the robustness of the Federal Government household carbon compensation package that is planned to be solely delivered through the tax and transfer system. Measures proposed include increased pensions and allowances in conjunction with changes in the tax thresholds. It is important to note these compensation measures are broadly based on income and family status.

It is also important to note that stationary energy bills comprise *on average*, approximately 50% of the cost impact on households.

Issues for Discussion/ Key Issues

If the Federal Government provides assistance through the tax transfer system there are 2 issues worth highlighting:

- 1 – The amount of compensation delivered to a recipient or category of recipients is not geographically sensitive. This results in the potential for inequality of distribution where some Australians will be over and others under compensated based on factors beyond their control. This is a particular issue given the higher average use of electricity in the northern states versus the southern states. This occurs as a result of differentials in fuel mix of households for example metropolitan Victoria (often dual fuel) vs country Victoria (all electric). In addition factors such as PV systems installed under a net or gross scheme avoid paying CO2 tax due to direct or indirect subsidies provided by other energy consumers and issues not factored into this briefing note.

2 – At a household level compensation delivered is not aligned to their individual consumption levels, and hence require increasing individual budgeting expectations with potential for increased energy hardship and at the extreme increases in disconnection.

1 – Geospatial impacts of the CO2 tax

NSW and Queensland residents are far more dependant on electricity than in Victoria¹ and South Australia, natural gas penetration in the southern states is high and is thus a perfect substitute for heating and hot water (the 2 biggest contributors to household energy use). The average electricity usage per state² is listed below:

State	Average household electricity use (MWh/annum)
NSW & ACT	7.4
VIC	5.7
QLD	7.5
SA	6.1
TAS	9.5

As outlined in the table above, Victorians use 77% of the electricity NSW residents use. To illustrate the distributional impact of the Carbon tax on household electricity accounts see the table below:

State	Average household electricity use (MWh/annum)	# Residential Electricity customers	Taxation per household (@ \$23 per megawatt hour adjusted CO2 intensity at 0.95)	taxation per households
NSW & ACT	7.4	3,000,551	\$21.85	\$161.69
VIC	5.7	2,190,588	\$21.85	\$124.55
QLD	7.5	1,697,545	\$21.85	\$163.88
SA	6.1	708,242	\$21.85	\$133.29
TAS	9.5	200000*	\$21.85	\$207.57

The above table demonstrates that Victorian and South Australian households *on average* are taxed at a lower rate per household compared to households in NSW, Queensland and Tasmania.

The basis for this inequity lies in the reliance on electricity in the states as opposed to a mix of electricity and reticulated gas. Within the states with significant reticulated

¹ (note Victorian metro consumption on average is 4.8 MW while non metro is 7.0MW)

² 2008/09 figures from ESAA EGA 2010 report

gas, such as Victoria, this is likely to be confined to the metropolitan and regional centres. Conversely for the non metropolitan areas there is a greater reliance on electricity as the availability of reticulated natural gas is less accessible in general than in metro areas thus exacerbating this differential.

The geospatial impact within a state is highlighted by the table below that details the variation in revenue raised though domestic electricity accounts only for Victoria.

State	Average household electricity use (MWh/annum)	# Residential Electricity customers	Taxation per household (@ \$23 per megawatt hour ajusted CO2 intensity at 0.95)	taxation per households
VIC	5.7	2,190,588	\$21.85	\$124.55
Vic dual fuel	4.8	1,380,070	\$21.85	\$104.88
Vic all electric	7	810,518	\$21.85	\$152.95

Implications of CO2 tax on dual fuel households

However when factoring the impact of the CO2 tax on reticulated gas this would add \$100 to the average annual Victorian dual fuel household, this is detailed in the table below.

Band (Annual Mj)	Taxation per household (@ \$23 per tonne ajusted at .0016kg per Mj61)	Difference
63000	\$0.00160	\$100.80

This results in giving a total distributional differential of almost \$50 per annum in variations of CO2 in taxation on various Victorian households, purely based on fuel mix.

State	Average household electricity/gas use (MWh/MJ/annum)	# Residential Electricity customers	Taxation per household (@ \$23 per megawatt hour adjusted CO2 intensity at 0.95)	taxation per households
VIC Av	5.7	2,190,588	\$21.85	\$124.55
Vic D/F ELEC	4.8		\$21.85	\$104.88
Vic D/FGAS	63000		\$0.0016	\$100.80
Vic D/F total		1,380,070		\$205.68
Vic all electric	7	810,518	\$21.85	\$152.95

Furthermore when the impact of CO2 tax on households with combined gas and electricity bills are considered it reverses the taxation impacts, with Victorian dual fuel households (and possibly others) experiencing a higher taxation burden than others.

2 – At a household level taxation other distributional impacts

Electricity consumption varies by household, often due to factors beyond the control of the individual; this includes not only their geography as referred to above but also personal factors such as owner vs tenant, income level (ability to invest in energy efficiency).

If we apply the above comparison to a sample of consumption of households that are assisted by the St Vincent de Paul Society, the compensation would be distributed as outlined below

Band (Annual MWh)	Taxation per household (@ \$23 per megawatt hour adjusted CO2 intensity at 0.95)	Difference
3	\$21.85	\$65.55
6	\$21.85	\$131.10
9	\$21.85	\$196.65
12	\$21.85	\$262.20
15	\$21.85	\$327.75
18	\$21.85	\$393.30

As a result of application of a carbon tax it disproportionately impacts on larger consumption households.

Summary

The above analysis demonstrates there is the potential for potentially regressive taxation due to the design of the carbon tax. As such the federal government should consider that part of the compensation mechanism be mindful of this.

Assuming that the compensation is to be distributed to households to ameliorate the impact of increased costs then allocation to households on the basis of how much electricity they use and the carbon content of this electricity is the only equitable and administrative efficient to remove these inequities.

The application of compensation directly on the bill at a per MWh / Mj is the only solution that can work to address a number of compensation objectives such as:

- Direct compensation proportional to energy consumption is efficient delivery of compensation directly to the cost impact (electricity retailers already distribute hundreds of millions of dollars a year in concessions and rebates)
- Removes the likelihood of increasing the unaffordability of electricity for those unable to invest in energy efficiency or those that are under compensated and hence exposed to increased disconnection and financial and energy hardship.
- Ensures there is no discrimination against people who have no alternative energy due to circumstances beyond their control such as the availability of reticulated gas
- Does not over compensate those who are already being subsidised through solar feed in tariffs and as such have insulated themselves from the impact of the carbon price
- Ensures the level of compensation can be directly in proportion to the level of impact
- Ensures the level of compensation can be adjusted as required by the Federal government over the longer term as the impact of the tax changes

The Federal government has the opportunity to ensure that households receive compensation on a per MWh / Mj consumed basis, at the time when energy bill are received. This approach is the rational, fair and achievable objective.

For more information contact Gavin Dufty SVDP 0439357129

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2.2 The proposed rule change by Major Energy Users (MEU) to limit the exercise of generator market power

In his paper to the conference 21C on 8 September 2009, ACCC commissioner Ed Willett identified that the National Electricity Market (the NEM) allowed some generators "... significant opportunities for price gouging" through the exercise of a generator's market power. He identified that when the SA regional demand exceeds ~2500 MW, Torrens Island Power Station (TIPS) has the ability to set the SA regional wholesale spot price. As a result of using this power, it appears that TIPS caused the average annual volume weighted spot price to increase dramatically as the following table shows.

Year	2004	2005	2006	2007	2008	2009	2010
Price \$/MWh	47.1	36.8	44.7	64.9	92.7	89.7	55.1

When TRUenergy owned TIPS (2004-2006), the MEU considered the regional prices generally reflected the costs of electricity production in the region. In 2007, AGL acquired TIPS, combining the largest retailer in the region with the largest generator. As AGL gained full control of TIPS (2008-2010) there were dramatic price increases.

In early 2008, the MEU raised their concerns with the AER about this apparent opportunity pricing but it was not until mid 2009, that the AER considered the issue needed to be addressed and Ed Willett made his presentation. The reason for consumer concern is that, as a result of the increasing wholesale spot price, generators increased their contracts with retailers and retailers increased their prices to consumers. What was also concerning was that the increase in price volatility caused some retailers to withdraw from the market as the risk is too high, reducing retail competition and those retailers that remained, increased their prices to manage the increased risks.

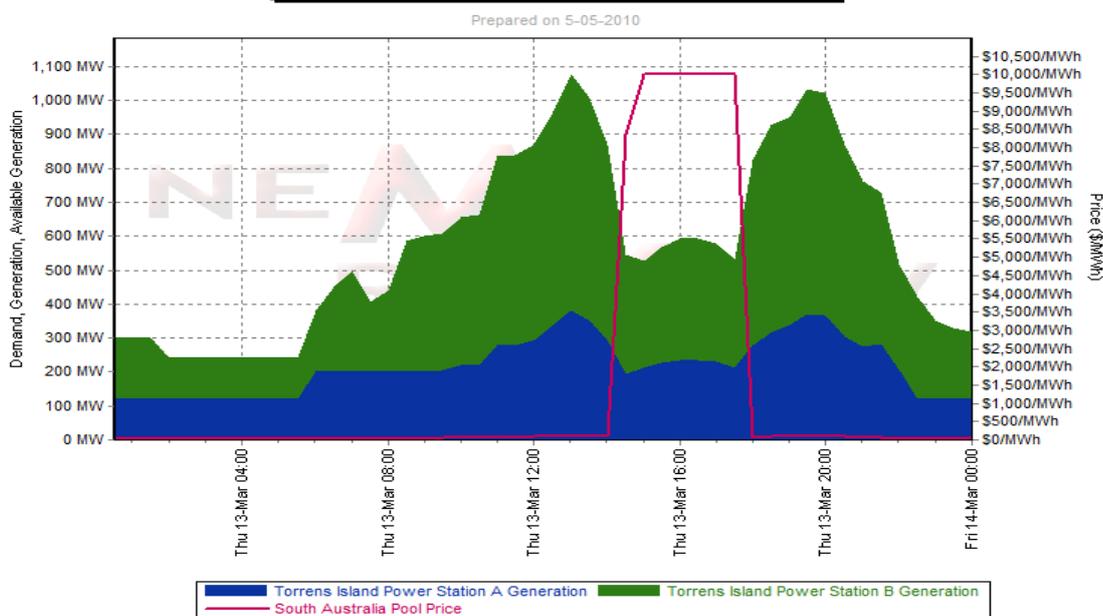
One consumer advised that their retail price for power increased by nearly 80% in one year as an outcome of these increases in the spot market. The retail price cap applying to residential and other small consumers has also reflected this increasing wholesale price for power.

Analysis by the MEU of the SA spot market showed that TIPS could operate within the electricity market rules but still manipulate the spot price reflecting the AER action not to pursue the issue with TIPS. In early 2011, it appears Flinders Power used the same market power approach as TIPS had in previous years. Further investigation showed that what was occurring in SA was also being seen in other NEM regions, including NSW and Tasmania. Even if the exercise of generator market power is only applied relatively infrequently its impact is very high as the table above shows. That the issue has been seen across a number of regions and by different generators in the same region suggests that this is a systemic failure in the NEM.

When electricity markets overseas were examined, the same phenomenon had been observed but overseas regulators had taken significant action to prevent it occurring.

The following example shows the impact on a large generator's revenue "spikes" of the spot price. At 1 pm on 13 March 2008, TIPS was generating some 696 MW and receiving \$100.94/MWh for its generation – an earning rate of ~\$70,000/hr. By 3 pm it was generating less than half the amount (316 MW) but receiving \$9999.72/MWh – a rate of \$3,200,000/hr!

Market data between 13-03-2008 and 13-03-2008



After reviewing how overseas regulators prevent generators from using their market power, the MEU has proposed a rule change that meets the needs of the NEM where incentive regulation is the driving force combined with minimum regulatory interference. The MEU proposal follows this approach and the proposal is much less intrusive than those seen in other electricity markets.

The main criticism of preventing economic withdrawal of generation to “spike” the spot price is that the large generator could be incentivised to physically withdraw its capacity to achieve the same outcome. For consumers this increases the risk that there will be blackouts. How the MEU proposal addresses this risk by providing incentives to stay generating. These incentives are backed up with rendering it against the Rules to physically withdraw capacity when the intention is to spike the price, combined with increasing the powers of the AER to prosecute.

What is a significant concern, is the lack of consumer involvement in addressing an issue that has the ability to both significantly increase electricity prices and at the same time, reduce retail competition.

For more information, go to <http://www.aemc.gov.au/Electricity/Rule-changes/Open/Potential-Generator-Market-Power-in-the-NEM.html> or contact the Public Officer of MEU davidheadberry@bigpond.com

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