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**Baethan Mullen**

**General Manager, Retail Electricity Price Inquiry**

**Australian Competition & Consumer Commission**

**23 Marcus Clarke Street**

**CANBERRA ACT 2601**

**Baethan.mullen@accg.gov.au**

**23 August 2017**

Dear Baethan

RE: Vertical integration in the National Electricity Market - Study by Frontier Economics

I am writing to you to provide a study commissioned by AGL from Frontier Economics that examines the statistical relationship between vertical integration and generator bidding behaviour. AGL is providing this as a further submission to the Australian Competition and Consumer Commission (ACCC) issues paper and asks that the ACCC accept it on this basis.

Public commentary about rising retail electricity prices and submissions made to the current inquiry by the ACCC into electricity supply and prices have suggested that a significant cause is the degree of vertical integration between electricity generation and retailing in the national electricity market (NEM).

In AGL's experience, vertical integration between generation and retail in fact leads to lower wholesale prices than those which would arise when generators are not vertically integrated.

The incentives on vertically integrated gentailers to ensure the availability of competitively priced generation is clearly demonstrated by AGL's operation, investments in (and improved efficiency of) Macquarie Generation and Loy Yang A since they were acquired in 2014 and 2012.

In order to assess whether quantitative analysis of the performance of the NEM since its commencement was consistent with AGL's experience we commissioned Frontier Economics to test (through the use of established statistical techniques applied to NEM bidding, dispatch and settlement data over a 14 year period) the extent to which, vertical integration has contributed to generators bidding more capacity at higher prices or physically withdrawing more capacity from the market, and the effects of other factors that may have contributed to bidding behaviour that causes prices to rise. The analysis found that the most important contributor to rising prices was the declining quantity of reserve generation capacity in the NEM.

Frontier Economics conclude that:

- Vertically integrated generators behave more competitively on average than when they were operating as stand-alone generators. Frontier Economics finds vertically integrated generators to be bidding 4% to 6% more capacity at competitive prices. Frontier Economics consider that this result is statistically significant and robust.



- There is no statistical evidence that the trend towards vertical integration across the NEM has contributed to generators bidding at higher prices.
- Further, there is no compelling statistically significant evidence that horizontal integration has caused generators to bid more capacity at higher prices.

The findings of Frontier Economics are consistent with the observable facts about the operation of the NEM in the last 2 years. A large quantity of older coal fired generators that used to provide base load generation have not been replaced with new base load generation, which has resulted in more expensive-to-run power stations generating more frequently with the effect of increasing wholesale prices. Frontier Economics conclude that the uncertainty around carbon pricing has led investors to not commit to building new base load generation.

Please find a copy of the Frontier Economics' study enclosed with this letter. AGL is happy to arrange a meeting between the ACCC's economics team and Frontier Economics in the event that you wish to explore the statistical techniques used by and findings made by Frontier Economics in this study.

Your sincerely,

A handwritten signature in black ink, appearing to read 'John Fitzgerald'.

**John Fitzgerald**

**General Counsel & Company Secretary**

Copy to: Dr Graeme Woodbridge, Chief Economist