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URGENT**

Dear Mr Rawstron

I refer to the request for further submissions from interested parties following the predetermination conference held on 13 August 2002 regarding NECA's proposed Code changes to address inappropriate bidding and rebidding strategies by generators in the National Electricity Market.

As you are aware, the South Australian Government is extremely concerned with aspects of the operation of the National Electricity Market (NEM) and its impact on the South Australian community. The Government called the pre-determination conference due to its concern that the ACCC's draft determination does not adequately address the inappropriate bidding and rebidding behaviour of generators in the NEM.

As was indicated at the conference, the Government recognises that providing generators with flexibility regarding bidding and rebidding strategies is essential for the efficient and effective operation of the market. This flexibility is fundamental to the design of the market as it provides scope for generators to manage risks such as those associated with plant operation, constrained fuel supplies and contract positions.

However, the Government fundamentally opposes generator bidding and rebidding strategies that exploit generators' market power and artificially raise prices in the NEM, which in the end must be paid for by households and businesses.

NEM Ministers endorsed this position at their meeting of 19 July 2002 and indicated that as a matter of policy they oppose generator bidding and rebidding strategies that are inconsistent with an efficient, competitive and reliable market, such as those not made in good faith, the blatant economic withdrawal of generation and the gaming of technical constraints.

While recognising the difficulties associated with addressing inappropriate bidding and rebidding, NEM Ministers called on NECA and the ACCC to develop further Code changes that will address inappropriate bidding and rebidding.

At the pre-determination conference there was much debate regarding the extent of market power in the NEM and how it should be measured. This is largely an esoteric argument among economists. All parties generally accept that the nature of the electricity industry means that generators are going to retain significant market power.

The Government considers that the recent price performance in the NEM, where generators appear to have been consistently able to set prices at extreme levels for weeks on end, clearly demonstrates the extent of market power in the NEM and the ability for it to be exercised.

The Government agrees with the ACCC's view expressed in the draft determination that some generators in the NEM possess substantial market power and that in some circumstances the current market rules enable such generators to take advantage of that power in their pursuit of profits.

The Government accepts that part of the solution may well be associated with addressing structural issues in the NEM, with the Government a strong supporter of the SNI project as it will provide more competition in the South Australian market. However, it is important that the ACCC adopt an approach that will address this inappropriate behaviour to complement any structural solution.

The Government supports the ACCC's decision to impose a requirement for generators to bid and rebid in good faith as the bidding process is an essential part of the price discovery process and it is important that participants have good information on which they can make decisions. Given the extensive debate regarding good faith, the Government considers that there is some merit in providing some guidance in the Code as to what is meant by good faith. However, in the end, it will be up to the National Electricity Tribunal to consider these issues on a case by case basis, review previous decisions by the courts and apply the concept to the electricity industry. Although we may not have absolute certainty, this is not in itself a case for inaction.

In the absence of the reversal of the onus of proof, it is important that NECA and the ACCC adopt an approach that will enable the good faith provision to be enforced. It is not novel or unreasonable to place some evidentiary burden on generators with the final onus of proof remaining with NECA.

In addition, the Government considers that the Code needs to be tightened to remove the potential for blatant economic withdrawal and the gaming of technical constraints. These strategies are inconsistent with the Code's objective of an efficient, competitive and reliable market.

While the Government has not undertaken a detailed analysis of the NECA proposal regarding the envelope of competitive price outcomes, it would appear to address many of the ACCC's concerns regarding uncertainty and increased compliance costs by significantly reducing the scope of bid and rebids that could be subject to review.

We note that the NECG paper on rebidding prepared on behalf of Macquarie Generation and the National Generator Forum indicates on page 33 that "... if the trading institution is functioning efficiently (in the mechanism design sense), the sequence of bids should allow progressively higher-cost capacity to be brought into the market as aggregate demand, and hence total consumer willingness to pay, rises".

It must be questioned whether the current NEM trading institution is operating efficiently when we have had high marginal cost, second hand distillate fired peaking plant located at Hallett operating in the early evening on many of these weekends while there is vast quantities of low cost coal plant being bid to levels in excess of \$5,000/MWh.

NEMMCO's publicly released data indicates that the average South Australian demand between 17:00 and 18:30 on Saturday and Sunday (18/5/2002 - 21/07/2002) was 1,536MW. During this time Hallett generated in 26 trading periods on 14 separate days. During the periods that AGL generated average demand was at 1,610MW. The latest Annual Planning Report published by the Electricity Supply Industry Planning Council quotes total installed capacity in South Australia as 3,347MW (pg. 23 APR June 2002, winter nameplate rating.) Therefore, in the periods during which AGL generated, up to 52 percent of SA's installed capacity was idle.

If the market were working as NECG has indicated, the plant at Hallett would only be operating on those days of extreme peak demand in South Australia, when there are technical difficulties or a requirement for fast start plant to accommodate an unexpected change in actual demand.

In addition, we understand that businesses in Adelaide are being asked by their retailer to shut down production during these high priced events but when overall demand levels are low. This is a serious concern because this voluntary demand side resource may not be available when it is required during actual periods of excess demand (ie there is a limit to the extent that business will accept continual disruption).

Consumers must in the end pay for these high priced generation and demand side resources as well as the additional risk premiums that must be factored into retail prices.

Electricity Full Retail Competition will be commencing in South Australia in January 2003, with many experts predicting significantly increased prices to small consumers. With wholesale energy costs equal to approximately 50% of a small consumer's bill, increased prices for wholesale energy have been identified as a key factor behind the increase.

Should this blatant gaming of the pool price by generators continue, confidence in the benefits of the national market will be undermined as the NEM is brought into disrepute and governments across the NEM will be forced to take drastic action to protect the interests of consumers.

Yours sincerely



**Paul Holloway**  
Acting Minister for Energy

6<sup>th</sup> September 2002