



**ENERGY SECURITY BOARD
CONSULTATION PAPER**

ACCC Retail Electricity Pricing Inquiry
Recommendation 1
February 2019

1. Purpose

Recommendation 1 of the ACCC's *Retail Electricity Pricing Inquiry*

The *National Electricity Law* (NEL) should be amended to prevent any acquisition or other arrangement (other than investment in new capacity) that would result in a market participant owning, or controlling dispatch of, more than 20 per cent of generation capacity in any NEM region or across the NEM as a whole.

The provision should be designed to prevent market participants circumventing the 20 per cent cap, including by way of ownership structure or contractual arrangements.

The Energy Security Board (ESB) is seeking stakeholder views on the following questions:

- Are there factors which stakeholders feel have not been adequately considered by the ACCC that would have a material impact on determining either:
 - the per cent market share at which the ownership cap is set
 - whether the ownership cap should be set in terms of nameplate capacity or some other measure.
- The ACCC envisaged exemptions to the ownership cap in cases where there is a takeover of a portfolio from an entity with no NEM generation capacity at the time. Should a degree of exemption also be considered for entities which own only a very small amount of generation capacity located in another NEM region?
- What factors should be taken into account when determining the dispatchable capacity of a generation portfolio?
- How should technologies such as variable renewable generation and demand response be accounted for?
- What factors should be taken into account when determining the AER's powers in relation to enforcement of the ownership cap?
- With regard to the compliance regime, what factors should be considered to ensure market participants are adequately incentivised to comply and cannot circumvent the cap (for example through changing company structures)?

2. Consultation timetable

The ESB invites comments from interested parties by **8 March 2019**. Feedback received will inform the ESB's advice to the COAG Energy Council.

Submission close date	8 March 2019
Lodgement details	Email to: info@esb.org.au
Naming of submission document	[Company name] Response to ACCC Recommendation 1 Consultation Paper
Late submissions	Late submissions will not be accepted
Publications	Submissions will be published on the COAG Energy Council's website, following a review for claims of confidentiality.

3. Background

In the *Retail Electricity Pricing Inquiry (REPI)*, the Australian Competition and Consumer Commission (ACCC) was of the view that the current wholesale market structure in the NEM is not conducive to vigorous competition and that market concentration has contributed to elevated wholesale prices. It noted that market concentration has substantially increased in recent years, primarily through acquisitions, with the NEM-wide share of generation capacity of the three largest retail companies rising from 32 per cent in 2011 to 48 per cent in 2018.¹

Underlying drivers of the increase in market concentration in recent years identified by the ACCC included sale of state-owned generation assets to existing market participants in New South Wales, consolidation of state-owned generation assets in Queensland and Tasmania, and closure of major power stations (Playford, Hazelwood and Northern).

The ACCC suggested a key impact of high market concentration in the NEM is lack of competitive constraint on generators' bids into the wholesale market when supply-demand conditions are tight, evidenced in New South Wales and Queensland by sustained bidding by coal generators at levels beyond that which can be attributed to fuel availability and cost increases. The ACCC considered that businesses are likely to be optimising generation portfolios partly with the objective of driving up prices.

In its *Wholesale electricity market performance report* (December 2018) the AER noted that there are elements of the NEM market structure which make it vulnerable to the exercise of market power. In particular, the output of a few large participants is required to meet demand for a significant proportion of the time.

The AER highlighted that while participants may have an ability to exercise market power, they may not have an incentive to do so. A range of factors affect a participant's incentives to exercise market power, including its exposure to spot prices and government intervention.

The AER did not find evidence of sustained exercise of market power, but it did note that pricing trends in Queensland and New South Wales cannot be explained by rising fuel costs, changing generation mix and physical issues alone. The AER noted that it will continue to monitor behaviour in both these regions closely in 2019. The ACCC considered that constraints on further

¹ As noted by the ACCC, comparison of shares by installed capacity overstates the market share of businesses with mostly peaking or fuel constrained generation plant which typically run for short, peak demand periods.

consolidation were necessary to ensure competitive bidding, and hence efficient prices, in the wholesale market in the future and therefore recommended further acquisitions be prevented which would result in a market participant owning or controlling more than 20 per cent of generation capacity in a NEM-region or across the NEM as a whole. It identified a number of factors in support of this position, including:

- The ACCC's s.50 powers under the *Competition and Consumer Act 2010 (Cth)* (CCA) are unlikely to stop acquisitions by a large incumbent generator or gentailer in an already concentrated market.
- Concentration of the ownership and/or control of dispatchable resources may become more entrenched with pending retirements of large thermal generators (the ACCC noted that an additional 2500MW of existing coal and gas plant expected to retire in next four years, replaced primarily with wind and solar).
- A structural solution is preferable to government directions or regulated bidding constraints to preserve the proper functioning of the NEM's energy-only market.²
- There are international and Australian precedents for restrictions to limit market concentration.

4. Generation ownership cap

Recommendation 1 of the REPI is targeted at restricting further concentration, by way of *acquisition*, beyond a set level – 20 per cent of generation capacity in the region. The ACCC considered it should operate as follows:

- To encourage investment in new generation, the 20 per cent cap should not apply to increases in a company's market share as a result of new investment.
- Firms currently owning or controlling dispatch of more than the 20 per cent threshold at the commencement of the provision should not be forced to sell down to the threshold level.
- Application of the threshold should make an exception for cases where a share of more than 20 per cent is the subject of a takeover by a person without any NEM generation capacity at the time of the acquisition.
- The calculation of 'capacity' should be based on the nameplate capacity of thermal/dispatchable plants, with adjustment measures applied to measure average dispatch of other technologies to account for capacity that is available in adjoining regions, and include the capacity owned or controlled by affiliated entities.

Recommendation 1 is intended to work with the ACCC's existing powers under s.50 of the CCA. Under these powers, the ACCC can seek to prevent mergers or acquisitions which have the effect or likely effect of 'substantially lessening competition', but its ability to do so is constrained by the requirement that negative impacts on competition be 'substantial'. The ACCC considered that implementing a cap on increases in market shares of generation by acquisition would

² ACCC, Retail Electricity Pricing Inquiry – Final Report section 4.1.2 discusses the impact of market concentration in Queensland; in particular evidence of unconstrained bidding by state owned generation businesses which make up the majority of capacity in the region and the Queensland Government's direction to Stanwell to introduce a constraint. The ACCC noted as part of this discussion (p92) that a structural solution is preferable for the proper functioning of an energy only market, given that it will not adversely impact price signals and will have an enduring effect on prices.

establish a clear and transparent basis for preventing increases in market concentration and consequent impacts on competition.

The ACCC considered the AER should have responsibility for enforcement of recommendation 1 but its assessment should extend only to whether or not a proposed acquisition results in the threshold being exceeded. It would not assess competition in order to determine a breach of the cap.

The ACCC further considered the AER should be given appropriate investigative powers and be able to seek injunctions, declarations and divestiture as appropriate to prevent or unwind any acquisitions which breach the requirement, with penalties set at the highest level available under the NEL, once increased in line with Recommendation 43.

The application of a cap to market shares by nameplate capacity would be relatively straightforward, but the key challenge would be in establishing an appropriate framework for adjusting the capacity of technologies which are not fully dispatchable (and/or regularly constrained off by congestion) and thus have limited potential to be used in bidding strategies to push up prices, along with capacity owned or controlled in other regions.

However, a capacity cap would operate as a relatively 'blunt' measure which would not fully capture the potential for exercise of market power; that is, the dynamic nature of the market in response to variable and inelastic wholesale demand, limited storage capacity, fuel and ramping constraints of different technologies and constraints imposed by hedge positions. Also, it would not account for the ability of some generators to constrain flows on transmission lines and thereby limit the dispatch potential of other generation.

An alternative approach, adopted in some international jurisdictions, would be to implement a cap based on the actual potential to exercise market power. While a number of possible metrics exist, these would all pose some benefits and drawbacks.

Consultation questions

Are there factors which stakeholders feel have not been adequately considered by the ACCC that would have a material impact on determining either:

1. the per cent market share at which the ownership cap is set
2. whether the cap should be set in terms of nameplate capacity or some other measure.

For example, how should factors like the dynamic nature of market responses and constraints caused by generators operating in the relevant geographic area, be taken into account?

Are there other approaches used in some international jurisdictions based on the actual potential to exercise market power that would be preferable to the ACCC recommended approach? What are the drawbacks of these approaches?

The ACCC envisaged exemptions for cases where there is takeover of a portfolio from an entity with no NEM generation capacity at the time. Should flexibility also be considered for entities which own only a very small amount of generation capacity located in another NEM region?

5. Application of the cap

The ACCC proposed that the calculation of capacity, for the purposes of applying the cap, should be based on the nameplate capacity of thermal/dispatchable generation units, with other types of capacity adjusted based on some measure of average dispatch or, in the case of power purchase agreements or 'PPAs', some measure of average purchase.

The ACCC further proposed that the calculation should account for a market participant's capacity that is available in adjoining regions, adjusted for interconnector limits and include capacity owned or controlled by affiliated entities.

Implementation of a cap, as proposed by the ACCC, would require criteria to be developed which outline how the dispatchability of various generation technologies would be assessed, as well as how the individual circumstances of each generator (ability to influence interconnector flow etc.) might be considered.

For example, the National Electricity Rules could establish adjustment factors based on the methodologies used by AEMO in its forecasting processes to de-rate different technologies and treatment of interconnectors. The AER could then be required to set a 'baseline' for each market participant owning or controlling generation capacity against which further acquisitions would be assessed.

However, standard capacity factors may not be fully suitable for this purpose, considering they do not take into account the flexibility of the resource (and hence its ability to be used to achieve price outcomes), only the average output over a given period. Further, it would be necessary to consider how demand response capacity is factored into any such assessment, noting the potential future introduction of a wholesale demand response mechanism and incentives for demand response aggregation through the Retailer Reliability Obligation and other measures.

Consultation questions

What factors should be taken into account when determining the dispatchable capacity of a generation portfolio?

How should technologies such as variable renewable generation and demand response be accounted for?

How should capacity owned in adjoining NEM-regions or the ability of some generators to influence transmission flows factor into the calculation?

6. Enforcing a cap

The ACCC proposed that the AER be responsible for enforcement of the ownership cap but that its role should extend only to undertaking an assessment of whether or not a proposed acquisition (or contractual arrangement) results in the 20 per cent threshold being breached. The AER would not undertake an assessment of competition in order to determine a breach; that is, its role would be limited to enforcement of an objective test.

The ACCC further proposed that the AER should be afforded appropriate investigative powers and be able to seek injunctions, declarations and divestiture to prevent or unwind any such

acquisitions and that penalties for non-compliance should apply at the highest civil penalty level (\$10 million).

Regulatory responsibility for enforcing compliance with the cap would align with the AER's wholesale market monitoring function and broader regulatory roles in the NEM, including any future role in regulating compliance with market making obligations, as proposed by the ACCC, and under the Retailer Reliability Obligation.

Consultation questions

What factors should be taken into account when determining the AER's enforcement powers in relation to the ownership cap?

With regard to the compliance regime, what factors should be considered to ensure market participants are adequately incentivised to comply and cannot circumvent the cap (for example through changing company structures)?