



Australian Energy Market Operator

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## Competition benefits consultation paper

AGL Energy (AGL) welcomes the opportunity to comment on the Australian Energy Market Operator (AEMO) Competition benefits consultation paper.

AGL is a leading integrated essential service provider, with a proud 184-year history of innovation and a passionate belief in progress – human and technological. We deliver 4.2 million gas, electricity, and telecommunications services to our residential, small, and large business, and wholesale customers across Australia. We operate Australia's largest electricity generation portfolio, with an operated generation capacity of 11,208 MW, which accounts for approximately 20% of the total generation capacity within Australia's National Electricity Market.

AGL does not support the inclusion of competition benefits analysis within the ISP framework. Competition in the NEM has not been shown to be ineffective in at least the last five years and achieving a competition benefit should only be considered where significant instances of the exercise of market power can be identified. We note that neither the 2018 nor 2020 *AER Wholesale electricity market performance* (WEMP) report found significant instances of the exercise of market power in the NEM. Modelling competition benefits is extremely difficult and unlikely to lead to accurate results. We consider it would be inappropriate to approve new network infrastructure on the basis of such speculative modelling.

The Frontier approach begins by equating competitive bidding with short-run marginal cost (SRMC) bidding. However, SRMC bidding is driven by the combination of competition and oversupply. If there is an undersupply participants can price above SRMC and be dispatched regardless of the level of competition in the market. This occurs when there are price spikes in the NEM because system demand is close to exceeding supply during a heat wave or may also occur at lower prices following the exit of a large generator. For example, following the exit of the Hazelwood generator in 2017 coal-fired generators more frequently priced up to gas as there was an undersupply of low cost capacity in the NEM. This behaviour was consistent across all the black coal-fired generators, including those with low market share, and was alleviated once more low cost renewables entered the NEM, so it was clearly due to an undersupply rather than ineffective competition. We note that the level of market concentration in the NEM has not changed significantly since 2014 (when AGL acquired Bayswater and Liddell), which further indicates that ineffective competition did not drive the high prices that occurred following the Hazelwood exit. Without pricing above SRMC, in the event of undersupply conditions there would be no price signal that new investment is required in the NEM and there would be no ability for generators to cover the fixed costs of their generation investment.

A further problem with modelling SRMC and assessing the withholding of capacity is that the SRMC and available capacity of a generator are not static. The risk or cost of capacity failure, tripping, and wear and tear on a generator will vary with the weather, seasons, and the age of the generator, and all these factors can lead to changes in the SRMC or available capacity of a generator. While the cost and opportunity cost of fuel (which should be included in any SRMC



determination) will be determined by the supply-demand balance of the fuel which can vary due to many factors including global supply conditions and local transport or mine issues.

The Ernst & Young (EY) methodology involves the identification of the key strategic bidders in each region, being those players that can respond to changes in other players' bids to maximise their profit. This is done by choosing the generators with the largest market share in a region, excluding hydro generators. This is a gross simplification as it ignores the impact of the bid stack and a generator's flexibility on a generator's strategic capability. A hydro generator which can easily vary output is much more likely to bid strategically than a brown coal-fired generator which needs to run constantly and can profit even at prices below the SRMC of black coal. We note that the 2018 WEMP report found that brown coal generators rarely set the price in any region following the Q1 2017 closure of the Hazelwood brown coal-fired generator, despite this being the period of most concern for strategic pricing by coal-fired generators in the history of the NEM. Coal-fired generators run continuously and cannot vary output significantly without increasing wear and tear or incurring expensive start-up costs. In contrast, hydro generators bid their capacity strategically varying output frequently based on the opportunity cost of the water stored in their dams to target peak periods, seasons, and years in which they can optimise Renewable Energy Certificate returns.

The EY methodology presumes regional geographic markets for competition amongst coal-fired generators even though when coal-fired generators set the price interconnectors are typically not constrained. We note that the price impact of the closure of Hazelwood on both NSW and Queensland coal-fired generator prices showed that coal-fired generators are generally in the same market from a competition perspective. While it may be argued that regional markets apply when interconnectors are constrained, coal-fired generators are less likely to be price setters in these periods.

If you have any queries about this submission, please contact Anton King on (03) 8633 6102 or [aking6@agl.com.au](mailto:aking6@agl.com.au).

Yours sincerely,

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