

## **AER approach to wholesale electricity market performance monitoring forum: Discussion summary**

<b>Matter name:</b>	Australian Energy Regulator (AER) approach to wholesale electricity market performance monitoring forum		
<b>Date:</b>	Friday 6 October 2017		
<b>Time:</b>	10:00am to 1:00pm		
<b>Location:</b>	Macedon room, PARKROYAL Melbourne Airport Arrival Drive, Tullamarine VIC 3045		
<b>Phone to</b> <input type="checkbox"/>	<b>Phone from</b> <input type="checkbox"/>	<b>Meeting</b> <input checked="" type="checkbox"/>	<b>Other</b> <input type="checkbox"/>

*Note: This document provides an overview of the main points discussed during the AER's forum on the approach to wholesale electricity market performance monitoring. Stakeholders held a range of views and there was not consensus on all issues during discussion. This document's use is purely informative.*

The Australian Energy Regulator (AER) held a public forum as part of our consultation on the approach to our new wholesale electricity market performance monitoring functions. The forum gave us the opportunity to listen to stakeholders' views on the issues raised in our discussion paper and engage with stakeholders on where we can add the most value. The forum also provided the opportunity for all stakeholders to understand each other's views, and priority issues.

### **Forum overview**

Our objective for the forum was to listen to stakeholder perspectives on:

- How should the AER approach its new functions
- Where can the AER's monitoring add the most value?
- What issues, analysis or tools should the AER prioritise?

As our objective was to listen to stakeholders' views, we organised the content and format of the forum to best facilitate discussion between stakeholders. We structured informal discussion sessions around five topics, which followed the outline of the discussion paper:

1. Key concepts - What do we mean by effective competition and efficiency?
2. How do we define the relevant markets?
3. How should we measure and assess market structure?
4. How should we measure and assess participant conduct?
5. How should we measure performance?

Stakeholders who had volunteered an interest ahead of the forum opened discussion for each topic. These initial discussants provided a starting point for discussion before we opened to the floor for comments from other attendees.

### **Summary of discussion**

Each discussion session was centred around a main topic. Due to time constraints, the discussion topics for session four and five were combined for a single final session.

#### *Session one: Key concepts – What do we mean by effective competition and efficiency?*

This session commenced with the initial discussant noting that the price of electricity should reflect the cost of production. However, effective competition is not as simple as comparing prices to costs, as there are a range of granular issues and factors that contribute to overall competition.

Stakeholders explored what the idea of effective competition could mean in an energy-only market. Discussion followed on the concept of 'workable' or 'effective' competition, which the discussion paper explored. Stakeholders noted that the design of the market allowed for some transient market power for cost recovery, and that sustained market power is a signal of a breakdown of competition. They noted the cyclical pattern that this creates. Due to this, and the wording of the NEL, stakeholders advocated for longer term analysis. Such analysis can also signal trends, and is more reflective of the expected timeframe for a new entrant to enter the market.

In conducting any assessment, stakeholders suggested the AER must determine if market power is causing high prices, or if genuine market signals are driving price changes. And if price increases are not part of a cycle, the AER should investigate if there are other external factors affecting the behaviour of participants. Stakeholders recommended the AER distinguish between ideal outcomes and workable outcomes. Some suggested merit in defining an aspirational target, but taking an approach that follows shorter term continuous improvement.

In general, stakeholders noted that there are a range of elements that make up the wholesale markets, and that the AER should divide the market up and dig deeper into the individual issues that make up each element. Some stakeholders also suggested that this extended to the supply chain as well, and that there are different elements in the supply chain that can affect wholesale outcomes, that are worth considering.

Finally, stakeholders also discussed demand response as being a potential contributor to effectiveness of competition. Some stakeholders looked at demand response as a way of breaking down barriers to entry, and reducing market power. Others argued demand response options are potentially helpful, but not solutions. Stakeholders agreed that more transparency around demand response would be beneficial, and that the AER could play a role in improving this information availability.

#### *Session two: How do we define the relevant markets?*

Session two's initial discussant opened by saying that the AER's approach should be flexible and future proof, as market issues are constantly changing.

Highlighting this, discussion began with stakeholders listing a range of products and markets that could be potentially relevant to assess. In particular, stakeholders drew attention to spot and FCAS markets. Others suggested looking at the products or markets participants would use to manage risk, particularly contract markets. Most stakeholders agreed that trying to monitor every issue at the same time would water down the value of the final report. Discussion focussed on how to prioritise issues.

Some stakeholders advocated prioritising analysis by potential harm to the consumer. Some recommended focussing on issues where analysis and monitoring can add the most value. Others suggested taking the time to consider all issues initially to gain an understanding, and using that to find the critical, important issues to focus on in the future. Further suggestions raised the possibility of a materiality measure, so that the AER prioritises issues that are likely to have a more significant impact.

In addition, some stakeholders recommended utilising the report to highlight potential issues to watch. This would provide a focus for future reports as they could follow up on these issues. It would also allow for reporting on the effects of significant market changes over time. Stakeholders also suggested that the AER not limit its reporting to the biennial report and that as critical issues emerge, the AER could conduct additional reporting on an ad-hoc basis.

Following on from discussion in the first session, stakeholders highlighted the value of a long term assessment of the market, and looking at the trends and patterns over time. However, some stakeholders also noted that no one time period will always be best for analysis, and the merit of a particular time period related more to the types of issues being assessed.

In discussing the geographic considerations, stakeholders agreed that undertaking assessment by regional level was a good place to start. Some stakeholders commented that there might be merit in looking further at sub-regional issues, and in some cases, the effect of regional factors on other regions and the NEM as a whole.

Stakeholders also agreed that, in defining the relevant markets, the AER should take care not to duplicate the efforts of other market bodies. Where a specific issue is already being monitored or investigated in detail, stakeholders wanted the AER to ensure there is no overlap.

Finally, some stakeholders suggested that the assumption of the functional level of the market in the discussion paper (wholesale) might be too narrow. In some cases, exploration of upstream and downstream issues will add merit to analysis. Some stakeholders also suggested that the impact of these issues might increase.

### *Session three: How should we measure and assess market structure?*

The third session began with the initial discussant asking whether the current market structure and design is fit for purpose, and if the founding assumptions are still relevant. The discussant also raised HHI and RSI as valuable measures of market concentration.

Discussion followed by recommending the AER take charge in defining how any metrics are used and should be interpreted. Clearly stating the context and purpose of each metric will reduce contestability or results. Stakeholders highlighted the importance of reinforcing metrics as indicators and signals, not outright determinations.

Stakeholders also noted the level of vertical integration as being valuable to analysis. Discussion touched on measuring the extent and type of vertical integration. For example, if a retailer is vertically integrated, asking what type of generation do they have access to, and how does that affect their need to hedge risk?

Stakeholders agreed that analysing barriers to entry is vital to determining the effectiveness of competition. In discussion, stakeholders raised the idea that some barriers to entry may be quite clear and not need much analysis. Similarly, it may be too difficult to assess the particular effect of some individual barriers, and investing resources in attempting to do so may not be worthwhile. Particular stakeholders raised policy uncertainty and market intervention as barriers to entry that they have recently observed in the market.

In general, stakeholders also referenced approaches taken by other market monitors internationally, and suggested the AER, in forming its approach, could learn from these. However, some urged caution in doing so blindly, and commented that only other energy-only markets would be worth comparison.

Finally, stakeholders also briefly discussed assessing participant conduct. Stakeholders cautioned against dissecting individual prices and categorising them as good or bad, as marginal and opportunity costs can vary greatly. Discussion also noted prices could also rise for a number of reasons that do not relate to efficiency or effectiveness of competition, and that there is merit in highlighting the factors behind price increases. Again, stakeholders reinforced the usefulness of a long term analysis to draw out trends and patterns. Particular stakeholders also advocated analysing the reasons behind price variations since the beginning of the NEM.

*Session four & five: How should we measure and assess participant conduct? How should we measure performance?*

This final, combined session began with discussion around finding which measures do and do not work. The initial discussant raised the possibility of greater consultation and workshopping of data and analysis so that there is communal support. Stakeholders were supportive of detailed engagement so that when the final analysis is publicly reported, all stakeholders can stand confidently by the data. The discussant furthered this idea, suggesting a stakeholder panel to review the information gathered and analysis used in the final report.

Stakeholders again suggested referring to the work of other market monitors internationally to see which measures do and do not work. As in session three, stakeholders highlighted the benefit of limiting this comparison to other energy only markets and noted that subtle differences in market parameters may affect the usefulness of certain measures. Stakeholders also suggested the AER engage closely with academic sources to draw on additional expertise.

While further discussion was limited due to time, stakeholders noted that a price versus cost analysis is a good starting point for analysis, as the AEMC performed this previously during the market power rule change request. Stakeholders discussed, without forming agreement on, a number of issues with this type of analysis, including: how to understand costs, how to benchmark costs, which type of cost estimation to use, measuring intangible, external factors on cost and the various drawbacks of any approach for estimation. Stakeholders cautioned against reusing measures and approaches that have been shown to not work in the past. Stakeholders also noted a need to clearly express the limitations of some forms of analysis and the risk that the AER's results could be misinterpreted.

Discussion also touched on how to measure efficiency in the market. Stakeholders supported qualitative assessment over estimating efficiency from modelled costs.

In general, discussion indicated that stakeholders preferred the AER consider using a wide range of data options and analysis measures, as more tools add dimension and understanding.