



MCE Standing Committee of Officials

**CONSULTATION
on
REGULATION IMPACT STATEMENT**

SEPARATION OF GENERATION AND TRANSMISSION

A Submission

by

The Major Energy Users Inc

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Executive Summary

The Major Energy Users Inc (MEU) welcomes the opportunity to provide its views on the regulatory impact statement (RIS) regarding the separation between generation and transmission in the NEM.

The MEU provides a view as to the current NEM operations and the impact this is having on consumers. Using this as a basis, the MEU develops its views on the various options developed by the MCE Standing Committee of Officials as to the most appropriate approach to limit co-ownership of generation and transmission in the NEM.

In developing its views, the MEU has revisited its reasons and experiences leading up to the submission of its rule change proposal to limit the exercise of generator market power to the AEMC. In this process, the MEU has identified a number of aspects that are common between its rule change proposal and the MCE SCO development of the RIS.

In its analysis, the MEU considers that none of the three options (A, B and C) proposed in the consultation paper, provide sufficient protection for consumers. As result, the MEU proposes its option (option D) which shares most of the features from option 3 assessed in the RIS development in 2007,

The features of the MEU option include:

- Acceptance of all co-ownership of generation and transmission that exists as of August 2011. As the consultation paper details these are not significant and do not impinge on the NEM.
- Recognise that governments in Queensland, NSW and Tasmania own both generation and transmission, and that they be required to ensure that governance of the businesses requires separation at Board level of each corporation.
- Basslink is effectively now controlled by Hydro Tasmania through a contractual arrangement. If Hydro Tasmania moves to acquire Basslink, the Tasmanian government should be required to ensure separation between generation and transmission.
- There should be no allowance of co-ownership, but the regulator can on request of the business allow an exemption provided that
 - The onus of proof there can be no ability to exercise market power lies with the applicant
 - Any exemption has a time limit
 - On expiry of the exemption, the business is required to divest itself of the asset

1. Introduction

1.1 About the MEU

The Major Energy Users Inc (MEU) represents some 20 large energy using companies across the NEM and in Western Australia and the Northern Territory. Member companies are drawn from the following industries:

- Iron and steel
- Cement
- Paper, pulp and cardboard
- Aluminium
- Processed minerals
- Fertilizers and mining explosives
- Tourism accommodation
- Mining

MEU members have a major presence in regional centres throughout Australia, e.g. Western Sydney, Newcastle, Albury, Gladstone, Port Kembla, Mount Gambier, Whyalla, Westernport, Geelong, Launceston, Port Pirie, Kwinana and Darwin.

The articles of the MEU require it to focus on the cost, quality, reliability and sustainability of energy supplies essential for the continuing operations of the members who have invested \$ billions to establish and maintain their facilities.

1.2 The MEU view of the market as a whole

It is necessary to put this issue of co-ownership of generation and transmission into context.

Consumers are seeing electricity costs rising very quickly, from a range of causes, such as:

- Generator market power (the AER has identified that Torrens Island Power Station in SA has market power when regional demand exceeds 2500 MW) and a significant contributor to this ability to exercise market power is that inter-regional connection is too weak
- Steeply rising transmission and distribution network prices – on average these will rise in real terms by ~50% over the next five years
- The electricity market exhibits excessive volatility in electricity prices, and as a result retailers are including in retail price offerings, large risk premiums which are causing significant retail price increases
- Implementation of the proposed carbon emission reduction program (carbon tax)

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- Implementation of the expanded 20% renewable electricity target (eRET) and the small renewable (SRES) program which have significantly increased costs for electricity consumers
- The indirect costs caused by the need to augment networks to meet the outcomes of the carbon tax and eRET requirements
- Sundry other Federal and State Government renewable energy and climate change programs and 'initiatives', such as feed-in tariff schemes, climate change levies, energy efficiency programs, etc
- Escalating risk premia and transactions costs in the NEM.

Overall, there is a general expectation that electricity supply costs will rise in real terms by 100% or more over the next few years as a result of these changes, which are also largely driven by myriad government interventions in a supposedly competitive market. This is having a chilling effect on downstream investments and creating an environment where ability to pay is becoming a major issue for all consumers, ranging from large industrials facing international competition to small consumers, especially in the lowest income quintiles.

In addition to the outcomes of the market noted above, the MEU has seen the increasing concentration of the NEM – especially in the re-aggregation of retail and generation. The original concepts behind the NEM (as propounded by Professor Hilmer) were that disaggregation of the vertically integrated government owned electricity providers would result in increased efficiencies, prevent the extraction of monopoly rents in sectors that are natural monopolies, and through robust competition in contestable sectors, deliver efficient services, when coupled with efficient economic regulation. In the monopoly sector, the disaggregation was intended to allow consumers to be more involved in managing their demand for electricity supplies and to minimise their costs through greater transparency.

Despite the initial moves in the electricity market to foster robust competition by diversifying ownership, the Australian electricity industry has, in fact, become more concentrated, along with re-aggregation between retailers and generators¹. During the 'reform period', this process of concentration has resulted in fewer retailers and three dominant vertically integrated "gentailer" businesses dealing in multi-fuels, including wind, solar and other renewable energy sources. Investments in new generation have largely been undertaken by these vertically integrated businesses who have also procured many generation assets made available for sale². There has been little interest by merchant/independent generators building new generation assets since the early period in the development of the NEM.

¹ For example, it is interesting to note that Origin Energy and AGL Energy are now larger businesses than any of the state owned entities that were the initial focus of the disaggregation

² These include the "gentrader" assets sold recently in NSW

These outcomes (ie fewer independent generators and a very few very large energy retailers which are also the major providers of new generation) would suggest that the barriers to entry by new entrants are higher now in both retail and generator sectors since the disaggregation process.

The MEU has analysed the degree of competition in the NEM based on calculations of the Herfindahl Hirschman Index (HHI), which is an indicator used to provide a helicopter view of market competition. The revealed trends are not encouraging.

For example, the HHI for retail in the NEM (now that EnergyAustralia, Integral Energy and Country Energy retail functions have been acquired by Origin Energy and TRUenergy) indicates that the electricity retail market is classified as “highly concentrated”.

Generation is classified as “moderately concentrated” on a NEM wide basis, but in each region of the NEM, generation is “highly concentrated” in all regions but Victoria, where it is classed as “moderately concentrated”.

Of interest is that the HHI for generation in the NEM states prior to disaggregation indicates that generation only just reached the classification of “highly concentrated”, and the market concentration of retail was of a similar order. This indicates that whilst the process for disaggregation of generation has achieved some small reduction in generation market concentration, the outcome for retail shows that there has been an increase in market concentration on a NEM wide basis.

Quantitative analysis, such as this, clearly reinforces the intuitive view that the NEM has achieved only small gains in generation competition (although there are marked regional differences) but retail concentration has increased markedly in recent years. Yet, despite such quantitative analysis demonstrating the reverse, there has been a curious mantra perpetuated by some, that competition has increased as a result of the disaggregation of the government owned vertically integrated supply businesses.

The minimal reductions in generation competition with reduced retail competition provides, prima facie, a view that there are significant barriers to entry of new generation and even more so for new entrant retailers. If these barriers are high enough that there is a reduction in competition in the so-called “competitive” elements of the NEM, allowing these barriers to be raised further by allowing the acquisition of monopoly elements is counter-productive.

1.3 The MEU view on generator and transmission separation

As a basic premise, the MEU does not consider that the competitive element of generation assets should be able to enjoy co-ownership of the monopoly transmission assets. This premise has been imbued in the NEM development

and in its precursor NEM1. The MEU does not consider that there is any driving change that warrants a move from this position.

The MEU notes that the reasons given in the consultation paper for a review of this issue include (page v):

- “a changed definition of transmission assets for Distribution Network Service Providers (DNSPs);
- national transmission planning becoming a function of the Australian Energy Market Operator (AEMO) on 1 July 2009;
- the transmission Service Target Performance Incentive Scheme which potentially reduces incentives for co-ownership;
- congestion management developments in the NEM that potentially reduce the ability to exploit market power;
- the Transmission Frameworks Review which is currently underway and impact on future co-ownership, depending on the review outcomes; and
- the Review of Enforcement Regimes which is currently being instigated that may strengthen the existing penalty arrangements.”

The MEU accepts that all of these changes have either the potential or have caused change to the NEM, but equally the MEU does not see that any of these creates a condition that warrants the need to reduce the requirements for separation between generation and transmission.

As noted above, already the NEM has provided opportunities for dominant generation businesses to use their market power to enforce a transfer of wealth from consumers to generators at times when dominant generators have an unbridled ability to set the spot price. This issue is the focus of the MEU rule change proposal (to the AEMC) to limit the abilities of generators to misuse their market power at those times when this is available to them³. It is interesting that a number of the issues addressed in that rule change proposal are similar to those raised in the consultation paper. The MEU will use some of the work it has carried out for that rule change to provide supporting evidence for its views on this Regulatory Impact Statement (RIS).

The consultation paper provides support for the view that allowing generation and transmission to be “co-owned” will result in savings from the scale of the activities undertaken and will provide an opportunity to reduce risks of participants. The MEU agrees that these outcomes are probable, but then raises the question as to who will benefit from these. The MEU points out that the National Electricity Objective (NEO) is about providing the most efficient market structure *for the benefit of consumers*. Competition has been identified

³ The documentation behind the MEU rule change proposal is available at <http://www.aemc.gov.au/Electricity/Rule-changes/Open/Potential-Generator-Market-Power-in-the-NEM.html>

as the most likely pathway for ensuring the maximum benefit will be provided to consumers. Yet this RIS contemplates that **less competition** might result in a consumer benefit. The MEU begs to differ. Whilst a change such as this might reduce costs to some participants, there is no guarantee that such savings will be passed on. In fact there is every expectation (and past performance in the NEM leads to this view) that the benefits will flow to shareholders of the supply side businesses at the expense of consumers. These businesses are not necessarily motivated by altruistic behaviour.

The MEU therefore is of the view that, unless it can be clearly demonstrated without qualification that any efficiency savings from reducing the current levels of separation will provide will flow to consumers, such a change is not warranted, and would not be in the long term interests of consumers.

The MEU provides in the following sections, the reasons for this strongly held view.

2. Context and Purpose

The MCE Standing Committee of Officials seeks feedback from stakeholders as to the benefits and detriments of changing the current view that there should be clear separation of ownership between generation and transmission assets in the National Electricity Market (NEM) and, if separation is to be maintained, whether the current arrangements are adequate to ensure this separation will continue into the future.

The Consultation Paper posits that the MCE sees there is a need to:

“... balance [between] preventing anticompetitive behaviour and allowing businesses to achieve economies of scale and scope.”

The consultation paper highlights that historically there has been a determination to ensure there is a clear separation of ownership between these two elements of the NEM because of the benefits that such separation engenders in the NEM. The consultation paper comments that there are some benefits that greater co-ownership might provide, including (see pages v and vi)

- “investors seeking portfolio diversification to balance risks and provide higher returns;
- generators can positively hedge their physical capacity in the financial market, becoming more attractive to a low-risk investor also interested in a transmission asset;
- jurisdiction-based government business enterprises may seek re-integration in an attempt to reduce overhead costs or improve cost efficiency;
- investors may seek co-ownership to improve the profitability of generation through coordinated activities with transmission; or
- government focus on structural separation has lessened following competition reforms in the 1990s and early 2000s.”

Other than (perhaps) the last dot point, the MEU agrees that all of these provide benefits to asset owners of generation and transmission. Even if the requirement for separation was reduced, there is no certainty that the already very large participants in the NEM – specifically the “gentailers” Origin Energy, AGL Energy and TRUenergy – would not act in the interests of their shareholders which are essentially about maximising returns.

The last dot point, whilst true, does not provide a benefit other than to reduce regulatory attention to the NEM (although it is noted there is continued government ownership of generators). The fact that in the majority of NEM regions, state governments still own generation, transmission and distribution assets, does not provide any basis for the lessening of the requirements for separation.

The initial MCE considerations on this issue seemed to revolve around whether the Trade Practices Act (now the Competition and Consumer Act) had sufficient strength without amendment to prevent a lessening of competition through integration of generation and transmission.

There were peripheral issues concerning whether a market transmission asset (MNSP) should be exempted from any ban, the degree of control that was required of the assets, potential forced divestiture and how a distribution asset owner with some transmission assets would be treated. Almost all of the peripheral issues can be readily treated by accepting the current status quo, but preventing further acquisition of transmission assets by generation and distribution asset owners. This recognises that with the current ownership arrangements, the extent of cross ownership between transmission and generation is minimal and does not create significant concern.

The consultation paper then cites a number of changes in the NEM since the last RIS review on this topic that might impact on decisions that might have been reached then. In section 1.3 above, the MEU pointed out that the changes cited have little or no impact on this issue and need not provide a basis for a change in view.

2.1 Clarification of the market

The MEU notes there is a need for clarification in the consultation paper's statement that (page 4):

“The NEM is an integrated market for the production, transportation and consumption of electricity within Australia's eastern and south eastern jurisdictions”

The MEU points to the 2010 ACCC consideration of the NSW Government's application for authorisation for a co-insurance arrangement between electricity generators and gentraders in NSW. In that assessment, the ACCC concluded that the wholesale market for the supply of electricity in the NSW is the NSW NEM region. That is, the market for power supply in NSW is limited to the regional boundaries and market issues for power supply in NSW are not to be considered on a NEM wide basis.

In that ACCC review, the MEU agreed with the ACCC's assessment that the relevant wholesale market for the supply of electricity in NSW is the NSW NEM region in its submission – see box article #1 which details the MEU reasons for supporting the ACCC in its decision that generation in NSW should be viewed on a regional basis and not as part of the NEM as a whole.

Box Article #1

MEU Comments on ACCC assessment of NSW Energy Privatisation

The MEU has consistently maintained that the NEM is not an integrated market but a series of interconnected regions. The impact of the frequency, extent and severity of resulting price separations needs to be incorporated into all reviews of the NEM. That this is the case has been clearly demonstrated to consumers who seek contracts from generators from an adjacent NEM region (e.g. a SA consumer seeking a contract from a Victorian generator). Consumers are unable to contract in such a form as the exporting generator sees that the risk of a constraint on an interconnector is too great for it to be able to guarantee to be able to supply. If this occurs now in the NEM, then it is unlikely to change just because the NSW government has implemented its proposed changes.

The ACCC is correct (in its determination concerning the coinsurance arrangements) in pointing to congestion and physical constraints on the interconnectors between the regions (e.g. between Queensland and NSW). These have led to significant price separation across all regions of the NEM.

As noted by the ACCC in its recent determination (ACCC, Authorisation Determination on Application by Macquarie Generation, Delta Electricity and Eraring Energy), in 2008/09 the NEM was not partially constrained at some point for only 70% of the time, implying the converse that there was price separation 30% of the time at some point in the NEM. For a supposedly fully integrated market, this degree of separation provides support for the MEU view that the NEM is not an integrated market at all, and that the NSW region should be considered alone for the basis for assessing the NSW privatisation arrangements with respect to the gentrader portfolios.

The MEU points to the following table showing the extent and frequency of price separations⁴ (which are quite significant) between NSW, Queensland and Victoria for the years 2006-2009:

Frequency of half hour price separations >\$50/MWh	2006	2007	2008	2009
NSW and Queensland	157	414	146	209
NSW and Victoria	141	424	182	359
NSW concurrently with both Queensland and Victoria	32	87	20	108

Source of data: NEM Review

⁴ For the purposes of this analysis, where the price separation between regions exceeded \$50/MWh, it is assumed that the interconnection between the adjacent regions is constrained

The above table shows that effectively NSW is partially constrained from being part of the entire NEM on a regular basis (i.e. separated from either Queensland or Victoria), and frequently isolated (i.e. effectively unconnected to both Queensland and Victoria at the same time).

When the frequency of such separations is factored into the analysis, this supports the view that the NSW generation market should be seen on a regional basis rather than on a NEM wide basis.

However, it is not only the frequency of such separations but the severity of them that needs to be considered. When a separation occurs, it allows the regional generators to operate in a less competitive environment. Where one or more of these generators has market power, spot prices can be driven to very high levels and which in turn will lead to significant transfers of wealth from consumers to generators (and now gentraders) with resulting deadweight losses to the NSW economy.

To assess the impact of these partial and total isolations of the NSW region, in Appendix 1 the MEU provides data (in a NEM wide format) which provides an indication of the severity of such partial or total isolation.

The tables included in Appendix 1 show that when NSW is effectively constrained the price impact of the separations causes, on average, nearly 30% of the annual average volume weighted spot price in NSW. So, in simple terms, the relatively infrequent episodes of high regional prices, contribute to a significant part of the spot price seen by users of power in NSW.

In this way it can be seen that although the frequency of partial or total isolation of NSW from the NEM might be considered not to be substantial, the severity of the impact of that isolation makes such constraints an issue of major concern as they provide an opportunity and an incentive for generators or gentraders to exercise their market power.

Accordingly, the MEU agrees that the constraints on the interconnectors between NSW and the Victorian and Queensland regions indicate that a NEM wide geographic approach to the wholesale market is not appropriate in considering the competition impacts of the proposed privatisation arrangements with respect to the gentrader portfolios.

Similar degrees of congestion between other regions (eg SA and Victoria and Victoria and Tasmania support the contention that the NEM is not a contiguous market as such, but a series of connected regions and the NEM should be viewed accordingly. In the decision by Justice French in the AGL vs ACCC decision, there was not sufficient experience of NEM operation or

sufficient actual data for him to reach a different view, although he did foreshadow that he expected changes in the NEM as participants became more experienced⁵.

There is no doubt that with the current levels of congestion endemic within the NEM, assessments of market power need to be addressed on a regional basis as the ACCC has done.

2.2 Statement of problem

The consultation paper raises three fundamental issues. Firstly, the CCA might not be sufficiently robust enough to prevent mergers of generation and transmission. Secondly, that vertical integration can provide increased efficiency and thereby provide a benefit to consumers. Thirdly, if such integration was permitted, then there is an increase in market power for the integrated business.

Both the second and third points are addressed in more detail in section 1.3 above. Essentially, the MEU concurs with the view expressed in the consultation paper and by governments, that integration of transmission and generation should not be permitted as the result will allow the integrated business reduced costs from increased efficiencies but which will not necessarily flow to consumers, and an increase in market power will result in increased costs to consumers.

The MEU notes the need for clarification in another consultation paper statement that (page 4):

“Vertical integration is generally more likely to result in the exercise of market power if at least one of the segments of the integrated entity is a monopoly”

The MEU points to its recent rule change proposal to mitigate the exercise of horizontal and vertical generator market power. In the proposal, the MEU considers that market power has been exercised to the detriment of consumers when there is vertical integration between a dominant generator and a dominant retailer, as demonstrated in South Australia. It can also occur (again to the detriment of consumers) when dominant generators take advantage of market separation in a particular region to exercise horizontal market power.

⁵ In its response to a report by Frontier Economics responding to the generator market power rule change, the MEU addresses the comments by Justice French in more detail. See the MEU response at <http://www.aemc.gov.au/Media/docs/MEU%20-%20Response%20to%20NEM%20Generators%20Group%20submission%20and%20Frontier%20report-b5c3ba08-af5c-40fc-ae3c-81543e32f520-0.PDF>

Indeed, the increased concern with market power in the NEM is illustrated by ACCC Commissioner and AER Member, Ed Willett in a speech to an Energy 21 C conference on 8 September 2009 – see box article #2.

Box Article 2

State of the Energy Market

Market power in the National Electricity Market

An emerging concern is that over the past couple of years we have seen an increasing incidence of generators exercising market power in the electricity market. This is not an everyday event. Indeed, the market was designed to minimise the risk of market power through an interconnected grid that allows competition between generators as far flung as northern Queensland, Tasmania and South Australia. Significant investment in networks, including regional interconnectors, has made this possible. The national market—covering all but Western Australia and the Northern Territory—is now fully aligned around 70 per cent of the time. While network congestion and other factors lead to some market separation, it is not usually severe.

But there are circumstances where a generator is required to be dispatched within a particular region and can easily exercise market power. This is most evident at times of peak demand, and typically on days of extreme temperatures. The opportunities for market power are further enhanced if part of the power system—for example, an interconnector—is constrained. This scenario can result in an islanded market with high demand and tight supply. In a relatively concentrated market, and given the “pure” nature of the electricity market, this can lead to significant opportunities for price gouging.

I will refer to three examples over the past couple of years. The first was in June 2007, when a combination of drought, plant outages and cold weather led to a tight demand–supply balance in New South Wales. While there was no evidence of a breach of the market rules, Macquarie Generation took advantage of market conditions by bidding around 20 per cent of its capacity at above \$5000/MWh during the peak 5 pm to 7 pm period. It was typically offering the same capacity at less than \$500/MWh at other times of the day. This led to average June quarter prices in NSW hitting a NEM record of \$146/MWh.

More recently, concerns about opportunistic bidding have centred on two other regions of the NEM—South Australia and Tasmania.

Price spikes in South Australia have been a feature of the past two summers. A significant proportion of South Australia’s electricity is sourced from Victoria via transmission interconnectors. The South Australian market was changed in December 2007 when Electranet reduced the maximum allowable flow on the largest interconnector by around 25 per cent. This limited the supply of low cost electricity from Victoria.

From January to March 2008—and again in early 2009—high seasonal demand and reduced interconnector flows allowed AGL to alter its bidding strategies for its Torrens Island power station—which accounts for 40 per cent of South Australia’s generation capacity. One strategy was to bid around 900 MW of capacity at around the price cap if demand was high. South Australia can source around 2500 MW from other generators and the interconnector, but beyond this Torrens Island must be dispatched. AGL was often setting prices around the market price cap of \$10,000/MWh at these times.

In the March 2008 quarter South Australian electricity demand exceeded 2500 MW in 230 trading intervals. Prices exceeded \$5000 in 51 of these intervals. This led to March quarter prices in South Australia hitting a new NEM record of \$243/MWh—topping the New South Wales peak I mentioned earlier.

The extent of price gouging activated the cumulative price threshold. This imposes administered pricing if the cumulative spot price over a week reaches \$150 000. Without the threshold—and the threat of its further activation—the number of extreme price events would almost certainly have been significantly greater.

So far in 2009, spot prices have exceeded \$5000/MWh on 27 occasions in South Australia. This has accounted for around 50 per cent of all high price events in the NEM this year. The bidding behaviour of AGL has been a contributing factor on at least several occasions. The events have typically occurred on days of hot weather and/or reduced import capability on the interconnectors.

More recently, market bidding strategies have emerged as a concern in Tasmania. Since 1 June 2009, the Tasmanian spot price has exceeded \$5000/MWh on 13 occasions. None of the spikes were forecast. They occurred when Hydro Tasmania made sudden and repeated cuts in the output of its non-scheduled (mini hydro) generators—forcing the dispatch of higher priced generation in its portfolio. The strategy was so sustained it led to administered pricing being applied for four days in June—the first time ever for Tasmania.

These unpredictable price spikes affect customers that buy electricity directly from the market (such as large industrial customers), the retailer (Aurora Energy) and potential new entrants. Large energy users trying to engage in demand management have been frustrated by these events, which include sudden spikes at off-peak times.

The MEU considers that the experience of the NEM already indicates that generators will exercise their market power if and when the conditions provide an opportunity when a generator has, because there is an absence of competition, the ability to set the market price. This highlights that the issue of where there is the potential for the exercise of market power, it must be addressed.

The MEU further notes the consultation paper's statement that (pages 4 and 5):

"Potential market power concerns associated with the co-ownership of both a regulated Transmission Network Service Provider (TNSP) and a generator exist due to the:

- Critical role of the transmission network in transporting electricity for all connected generators; and
- incentives of a co-owned TNSP to provide transmission services that favour the affiliate generator in order to maximise its profits"

The MEU agrees with the above concerns and adds that there are also very important impacts on operational and investment efficiency, as a result of price distortions or competition issues.

A paper written under the guidance of David Newbery⁶ provides useful guidance on this issue as it is also important, in discussions about co-ownership of a regulated TNSP and a generator, to distinguish between (Newbury page 8):

"...the exercise of system-wide market power from local market power. The former refers to market power occurring at the broad market level, typically due to the existence of dominant generators and/or tight supply conditions. Local market power arises when transmission constraints create isolated geographic markets in which the broader market players can only minimally participate".

In addition to the above aspects of vertical integration – i.e. a generator and a transmission operator – the MEU points to the existing combination of transmission with distribution, for example, AusGrid in NSW and SP AusNet in Victoria. Removing the constraints (if this is the case) to enable a combination of a generator with either AusGrid or SP AusNet will mean a return to a highly re-aggregated vertically-integrated business model that will provide extra scope for the exercise of both horizontal and vertical market power.

The MEU agrees with the consultation paper statement that (page 5):

"The CCA could theoretically prevent a proposed merger or acquisition between a TNSP and a generator from taking place in the NEM if it raised

⁶ "A review of the Monitoring of Market Power: The Possible Roles of TSOs in Monitoring for Market Power Issues in Congested Transmission Systems" by Paul Twomey, Richard Green, Karsten Neuhoﬀ and David Newbery 05-002WP March 2005 for the Centre for Energy and Environmental Policy Research (CEEPR), available at <http://dspace.mit.edu/handle/1721.1/45032>

significant competition concerns. It is unclear, however, whether such a proposal would actually be blocked if such a case were taken to court. Additionally, the CCA cannot prevent co-ownership as a result of a TNSP building a generator (or vice versa)".

Overseas research shows rising concerns with the exercise of market power in overseas electricity markets, as Newbery notes (page2):

"The experience of countries that have liberalised their electricity markets has shown that the assumption that markets will naturally produce a competitive result is not always justified"

Newbery adds (page2):

"Transmission system operators (TSOs) are concerned with the secure and efficient operation of the electricity system. (However)...market power adversely affects this objective".

and

"TSOs should therefore be interested in contributing to measures that limit market power to avoid these negative effects, and are also well placed to provide information to aid the monitoring of market power".

These observations highlight the concerns outlined in the consultation paper that there is an essential difference in objectives between generation and transmission that would be lost should the two be integrated under one owner⁷.

On page 4 Newbery adds:

"The US experience is of particular relevance to transmission system operators, since market power monitoring in that country is normally carried out by the Independent System Operator, some of which have, or hope to, become Regional Transmission Operators. The system operator naturally has access to much of the data that is required for effective monitoring, including a complete description of the transmission system, and continuous records of generator outputs, demands, and power flows. These system operators are also independent of any market participant, which should ensure their objectivity in dealing with sensitive matters. A system operator that is still integrated with generation or retailing, however, is unlikely to be a suitable host for an independent market monitor."

⁷ It is recognised that in Queensland, NSW and Tasmania, the government owns transmission and generation. It is expected that government ownership is exercised in such a way that the inevitable conflicts are appropriately ring fenced by the establishment of independent corporations under different Boards.

It is worth assessing the conclusions of Newbery et al – see box article #3

Box Article #3



they are necessary to justify their considerable additional resource requirements,

There is no doubt that segregation of generation and transmission must be maintained. The consultation paper raises the view that general competition laws (such as the CCA) might be able to address the potential of re-aggregation between these two sectors but the MEU does not consider this is the case. The consultation paper highlights the outcome of the AGL vs ACCC case where the TPA was not able to prevent the acquisition of part of Loy Yang power station by AGL.

Further, the MEU rule change proposal to limit exercise of generator market power highlights that the TPA is not considered to be adequate to prevent the exercise of generator market power. That this is the case is exemplified by the AER in its annual market reviews noting that generator market power has been exercised to the detriment of consumers but despite this, the AER (nor its parent ACCC) consider they can address the issue through the TPA. Such an outcome is to be expected as general competition laws (similar to the TPA) have been inadequate to prevent the same problem occurring in overseas electricity markets⁸. This has resulted in specific laws and rules for electricity markets being developed to minimise market power issues.

⁸ The MEU rule change proposal now lodged with the AEMC examines this and discusses the actions taken in other competitive electricity markets to prevent the exercise of generator market power.

2.4 Conclusions

The MEU seeks to clarify the consultation paper's statement (page 6) that:

“The impact on the market of cross-ownership in other aspects of the supply chain have different impacts on the degree of competition in the market. Between the competitive generation sector and the retail sector there is a natural synergy that can be optimised through vertical integration. This is because retailers can hedge against high and volatile wholesale electricity prices through ownership of a generator that operates in the NEM, preferably in the same region as the retail business' operation.”

Whilst the MEU sees that aggregation of generation and retail do provide synergies to the aggregator, the MEU has also seen that this form of vertical integration opens up the scope for the exercise of generator market power and the MEU concerns are well developed in its rule change proposal on generator market power. The MEU has seen that the outcome of this vertical re-aggregation of generation and retail has led to a lessening of overall competition, the increasing of barriers to new entrants and the development of three very large “gentailers” in the NEM. Consumers have seen that the emergence of these three large gentailers has caused a reduction in competition in retailing and a degree of marginalisation of second tier retailers.

Overall the MEU is of the view that any lessening of the concept for strict segregation of common ownership of generation and transmission must be resisted. The experience of overseas electricity markets indicates that electricity markets are not easily controlled in terms of general competition laws and specific laws and rules are probably required to ensure that this separation is maintained.

3. Effectiveness of the CCA in Regulating Electricity Vertical Integration

Section 2 of the consultation paper discusses at length various (and often competing) views about the ability of the TPA to address competition issues in the NEM. The MEU points to the ineffectiveness of Section 50 of the CCA (which prohibits acquisitions that would have the effect, or a likely effect, of substantially lessening competition in a substantial market in an Australian state or territory).

It is pertinent to note that various parties over the years have expressed a view that section 50 would provide sufficient strength to the ACCC to prevent the re-aggregation of generation and transmission. The MEU begs to differ. The fact that the ACCC had significant concerns about the partial acquisition of Loy Yang power station by AGL to deny the acquisition but lost this case on appeal, indicates that proving a lessening of competition (often assessed in terms of inference rather than actuality) is significantly difficult. That the ACCC specifically identified the electricity market as requiring specific laws and rules so that they could better manage issues of competition, supports the view that such is a challenge.

Recently, the UK introduced a new law to address the competition issues that arise from congestion in the UK electricity market as managing it under general competition laws was not possible. Specific laws and rules have been introduced in US competitive electricity markets to ensure that competition issues are properly managed. The fact that this has occurred is strongly indicative that general competition laws are not sufficient to address competition issues.

In the consultation paper, the review by ERIG was introduced as supporting a view that the TPA was adequate. In its final report, ERIG does evince a view that the TPA is adequate for addressing competition concerns, yet in the report ERIG observes (page 141):

“ERIG has found some evidence that is suggestive of non-competitive market outcomes having an adverse impact on the economic performance of the NEM ... Individual behaviour of generators within the NEM, in compliance with the NEL rules, is not illegal under the TPA ... ERIG does not believe that changes to the TPA are an appropriate response ... [and] notes that, overseas, competition issues (eg, market power mitigation) are explicitly covered within market design and operating rules, rather than through adjustments to competition policy instruments such as the TPA.

With the exception of the requirement that generators bid ‘in good faith’, the NEL currently does not address market power specifically, or even the conditions under which it would be appropriate to do so. This appears to be in

contrast with ‘best practice’ considerations for managing unilateral market power in electricity markets (see, for example, Wolak 2006).”

That ERIG supports NEM specific laws and rules to address some competition concerns indicates that it also considered the electricity market needed special attention in regard to competition issues.

Section 2 also discusses the ability of section 46 of the TPA to address misuse of market power. The MEU’s rule change proposal to mitigate generator market power demonstrates that the approval of the AGL/TIPS merger under Section 50 of the TPA has been detrimental to the interests of consumers, as it had enabled the persistent and easy exercise of market power by a vertically-integrated business involving a dominant generator and a dominant retailer because section 46 does not provide the powers necessary to address the misuse of the market power that resulted from the acquisition of TIPS by AGL.

The MEU rule change proposal examines the ability of the TPA to address the outcomes of the exercise of market power. It points out that the TPA is designed to ensure there is no lessening of competition. Overseas experiences in electricity markets have shown that specific rules are required in electricity markets to prevent acquisition and exercise of market power due to the unique features of electricity markets.

As pointed out by the MEU, the CCA is unable to deal with the issue of generator market power and has accordingly sought to establish a rule change under the NER to specifically deal with behavioural change. In this regard, there is no reason why there should be any confidence that the CAA (which is intended to be of general application to the economy, including to those sectors that claim competition issues) could deal with competition concerns arising from generation and transmission mergers.

In its application for a rule change, the MEU provided its views on the application of the TPA to the issue of generator market power – see box article #4

Box article #4

MEU generator market power rule change – application of TPA

It is assumed that the misuse of market power is precluded by the Trades Practices Act (TPA) and there have been decisions using the TPA that have addressed the misuse of market power. The electricity market rules require issues of competition to be addressed under the TPA but sections 46, 47, 48, 49 and 50 of the TPA (which address the misuse of market power) do not directly address the exercise of market power to increase profitability and thereby increase prices, but are focused on lessening competition. As the primary outcome of the exercise

of market power in the electricity market is to increase profitability, it would appear that the TPA does not protect consumers against this practice. Nor is there any remedy under common law against what is a modern form of “engrossing” by a dominant supplier.

The assumption behind the approach of the TPA, to address competition aspects, is that it is by competition that consumers will gain the least cost for the provision of a commodity or service. The TPA therefore is predicated on the principle that maximising competition will provide the best outcome for consumers. This is true but competition cannot be easily improved where there is no instant freedom of entry and new generation plant cannot be quickly built and commissioned.

Examining this issue from the viewpoint of a business with market power, suggests it will use its market power to increase its profitability. Yet because it is not using its market power to damage competitors through predatory pricing, the TPA will not apply. The TPA focuses on whether conduct damages competitors, not on the effect of the actual exercise of market power to extract monopoly revenues from consumers and users.

Because of the uniqueness of electricity, (with its low inelasticity of demand, and the need for concurrent supply and usage) attempting to apply general competition laws (such as the TPA) is inadequate.

... Because the TPA does not prevent the strategic bidding behaviour undertaken by generators in the NEM, and the NER is unable to protect the interests of consumers against the exercise of generator market power, it is clear there is a need to introduce a rule change to constrain the abilities of dominant generators to use their market power to increase the spot price above what would otherwise result if there were adequate competitive pressures.

This case is not unique. Because the TPA does not cover every form of market abuse, the Australian share and futures markets have specific rules against market rigging and price manipulation through abuses of trading orders. These are enforced by the ASX and ASIC and backed by rigorous investigatory powers.

The MEU also sought legal advice regarding the application of the TPA to issues of market power in the NEM and this confirmed the MEU view (and of overseas regulators) that specific laws and rules are required in electricity markets regarding competition issues, due to the unique nature of electricity markets.

Whilst the consultation paper recognises that there are differences in views as to the effectiveness of the TPA to address issues in the NEM, both overseas experience and the actual outcomes indicate that the electricity market needs specific laws and rules to manage competition issues.

4. Market Power Abuse Concerns and Current Arrangements

In section 3 of the consultation paper, there are identified six issues that are considered in respect of the potential for market abuse to occur should there be co-ownership of generator and transmission assets. The MEU agrees that together they provide a comprehensive summation of the key concerns that might arise.

4.1 Reduction in transmission service quality and connection for competition generators

The MEU agrees with the discussion and the listings of the aspects in the consultation paper and supports the view regarding the current limitations stated. The work by Newbery et al support the concerns raised here – see section 2.2 for the MEU views.

4.2 Investment and Maintenance Decisions (such as planned and unplanned outages) made in favour of the co-owned generator

The MEU agrees with the listings of the aspects and the implicit limitations of the current rules.

Given the highly concentrated nature of the energy market in Australia and the dominance of the three main players, with vertically integrated businesses, it is unlikely that new players will enter the market. Also, given the scope for islanding of NEM regions, the scope for exercise of horizontal and vertical market power is very high.

The MEU agrees that without separation of networks from generation and retail, the risks of discrimination and anti-competitive behaviour are very high.

The MEU agrees with the concerns discussed in the Consultation Paper.

4.3 Sharing of Commercially Sensitive Information

The MEU agrees with the listings of the aspects highlighted. A TNSP has considerable amount of information about generators and consumers and is in a position therefore, to undertake anti-competitive activities against competing generators. The research by Newbery et al, point to the importance of independence of the transmission operator.

The MEU agrees with the concerns expressed in the consultation paper and notes that the trade off between the reward from exercising market power and the financial risks of doing so need to be recognised and accepted that if rewards exceed a penalty, then anti-competitive behaviour becomes a viable option.

4.4 Changing Short-term Current Ratings

The MEU agrees with the listings of the aspects and the concerns expressed in the consultation paper.

The MEU experiences gained in addressing the issue of exercise of generator market power and in regulatory reset reviews reinforce the concern that the market entities of AEMO, AER and AEMC are always in the position of not having the same extensive information the market participants hold and therefore to expect an entity to be able to control aspects such as line rating changes would be extremely problematic.

4.5 Transferring costs incurred by a generator to a regulated TNSP

The MEU agrees that although there would be difficulties in transferring significant costs from one entity to another, this is not impossible. As there is a large information asymmetry between regulator and TNSP, it is likely that some of the costs could be transferred.

4.6 Perceived Loss of Market Integrity by Market participants

The MEU agrees with the listing of the aspects and the concerns expressed in the Consultation Paper.

5. Options for the Reduction of Market Power Concerns

In the consultation paper there are listed four policy options for addressing competition between generation and transmission. These are access regulation, ownership separation, operational separation and accounting, functional and corporate separation.

The listing of advantages and disadvantages of each are provided, but one theme seems to be common to all – that is, all of them to some extent imply that economies of scale provide a significant benefit and this could be captured. The MEU agrees that economies of scale can provide benefits but the issue is whether these will deliver increased value to consumers. To consumers, increased efficiency is only of benefit if the efficiencies translate into savings over the long term to consumers. In this regard, the key aspect of a benefit must be that there is a high likelihood that the benefit of the improved efficiency will accrue to consumers. Unless this occurs, the benefits of the improved efficiency will remain with the business.

The MEU therefore is of the view that unless the efficiencies from increased scale of operations can be assured to go to consumers, then this benefit should be disregarded. Against that, there must be an assumption that increased market power will be used to the detriment of consumers, in the same way as it is currently used by generators in the NEM.

The MEU does not consider that those benefits consumers might get from increased scale of operations (particularly as these are likely to be discounted by the business) will offset the actualities of the costs of increased market power. Therefore, at a qualitative level, the separation approach that minimises market power should be seen as the optimum solution and any other option should be benchmarked against this when assessing if there is sufficient benefit to make a change.

Thus, as a starting point, the MEU considers that ownership separation is the benchmark provision.

The MEU notes that there may be an issue where a TNSP considers that a network support service, in the form of generation, might provide a lower cost than building network assets. Generally, network support is considered to be a short term option to building new network assets and usually requires a relatively small generation proposal. Whilst the MEU recognises that to implement such an option might provide a benefit to consumers, there is no reason why a TNSP would be the only party prepared to provide such an option. Usually a network support service is called for as a third party tender and not provided by the TNSP. If a third party tender is not provided it may mean that the concept developed by the TNSP is not the most effective and commercially attractive approach

possible. The MEU does not consider that this example should provide the basis for an exemption from the basic premise.

Option A: Maintain the Current Arrangement

The MEU notes that there have been few co-ownership examples since the establishment of the NEM and agrees to an extent with the observation in the consultation paper that (page 36):

“This is likely due to the different business models and risk exposures to generation and transmission businesses, the limited scope for efficiencies with owning both generation and transmission businesses and the existing rules under the CCA. As such, there may be minimal benefits in developing detailed rules to address a risk that is unlikely to arise in the future”.

The MEU notes the reference to the minimal risks involved, but also notes the observation that (page 36):

“...the ACCC has raised several concerns against maintaining the current provisions as the only defence against market harm following co-ownership”

The MEU, however, considers that there is a need to review the level of risks in light of recent developments in the energy market and the likely outcomes from the Transmission Frameworks Review. Further, the consultation paper makes reference to the minimal benefits that might accrue from developing detailed rules for something that may never occur.

In this regard, the MEU notes that its rule change proposal was initially deemed by some to be unnecessary as the exercise of generator market power was considered transient in nature. Deeper analysis (by the MEU and the AER) shows that this is not the case and that it is a systemic flaw in the NEM design. There was also a view that the issue would and could be managed through general competition laws, but this has proved to be incorrect, both in the NEM and in overseas competitive electricity markets.

With this experience in mind (coupled with the experience from overseas) not to make change because the costs of doing so might not equate to a benefit (that the MEU considers is unlikely to occur) is short sighted and provides a potential avenue for a larger detriment in the future.

The MEU considers that, just as there is a need to address the exercise of generator market power specifically within the rules, so should the issue of separation between generation and transmission. In this regard, if it were considered there is no need because of the application of general competition laws, there would be no concern that the NEM rules were explicit that such behaviour is not permitted. The MEU considers that an

explicit ban on undesirable activity is much more preferable to an implied ban. It has the added benefit of not being able to be overturned at a later date.

The fact that supply side entities might support retention of the status quo, raises concerns that they consider it possible that they could get around the general competition laws at some future time. If there is a view that the future risks are minimal, they should not have a reason to exclude an explicit provision banning co-ownership.

The MEU considers that there is a need for an explicit ban on co-ownership of generation and transmission (similar to the stipulation in the gas industry) rather than assuming the general competition laws will prevent this occurring.

Option B: Enhance the Current Transmission Ring-fencing Guidelines to formalise the Provisions and Review the 5 percent Revenue Threshold Level for Co-ownership

Instituting ring fencing and its associated interrogations proving that it is working has proven to be a challenging exercise, and there are a number of examples in the Australian context that ring fencing has proved to be problematic.

Even where there is ring fencing there has remained a residual concern that information does cross over the “fence” and this provides a detriment to the market as a whole.

Currently the issue of co-ownership of generation and transmission in the NEM is small (perhaps insignificant) so the introduction of an explicit ban will have little impact, so its introduction will result in little detriment (if any) to supply side entities.

The MEU considers that introduction of a “halfway house” when a better approach can be readily introduced appears to be inappropriate.

Option C: Reconsider the Preferred Option Proposed under the Original consultation RIS in 2007 – Generation/Transmission Mechanism with a Percentage Exemption plus MW Exemption

This option involves insertion of a generation/transmission provision in the NEL containing an exemption test and provides deterministic levels of co-ownership (transmission must not exceed 20% of the generation business’

activities⁹) and generation owned by a TNSP must not exceed 5% of the business activities nor less than 30 MW installed capacity. Greater percentages and installed capacities up to 150 MW are permitted under certain circumstances with approval of the regulator.

The MEU has commented above that provision of network support services should not be a consideration of co-ownership – network support services should be provided by third parties to ensure that the lowest cost results for consumers.

The MEU also considers that as there is no need now for allowing greater than 0% ownership to address current ownership levels (other than government owned assets) then there is no need to introduce any deterministic “permitted” levels of ownership. To allow provisions above 0%, provides the basis for achieving greater levels at a later stage and if they are not needed now, why introduce such a provision?

Whilst option C has a greater attraction than the other two options, it is not the preferred option of the MEU.

Option D: The MEU preferred option

The MEU prefers an option similar to option 3 outlined in appendix C to the consultation paper.

The MEU considers that there should be a general presumption that there will be no co-ownership of transmission and generation. This is easy to implement now (subject to recognising the limitations of this approach which would require an exemption in the case of government owned generation and transmission) as there is no substantive requirement for divestment as the consultation paper (in appendix A) highlights that the only privately owned generation co-owned with significant regulated transmission assets, are not connected to the NEM and therefore would not be impacted by a new rule in the NEM rules.

Appendix A in the consultation paper does point out that the government owned generator Hydro Tasmania has a substantial interest in the privately owned Basslink although this is currently not an ownership interest. This effective interest in Basslink already allows Hydro Tasmania to exercise its market power if it wanted to but the operation of Basslink does not really permit the exercise of any market power in an operational sense.

⁹ The RIS does not state on what basis this 20% is assessed eg on asset value, revenue, profit, etc. This needs to be established

However, on a pragmatic basis as Hydro Tasmania is government owned, if it did acquire Basslink, the government could take action to prevent Hydro Tasmania from exercising any additional market power

The only drawback to this option quoted in the consultation paper is that it reflects the New Zealand approach to separation which might not apply in the NEM as ERIG had observed that (page 64) the:

“... New Zealand market, vertical integration has led to the concentration of the market into five integrated entities. The nodal pricing design of the New Zealand market, together with vertical integration, has given rise to regionally dominant ‘gentailers’ (ie, resulting in major horizontal aggregation within regions). Here, the problem appears to be horizontal aggregation within regions, with which vertical integration is associated.”

The NEM has developed its vertically integrated “gentailers” and the gentailer market sector has aggregated into three entities only, with gentailers being larger than the original government owned vertically integrated businesses that were identified as inefficient and monopolistic.

With this in mind, the reason for excluding option 3 has now disappeared with the rise of the NEM’s own gentailers.

The MEU considers that perhaps having an exemption permitted where the burden of proof lies with the applicant to demonstrate that allowing some co-ownership to exist has some merit. If such an exemption is permitted, it must have a declared life (eg apply for a set number of years) and on expiration of the declared life, the asset must be divested so the entity returns to the 0% ownership that applied before the exemption was granted.

As noted earlier, applying zero tolerance is unlikely to cause much loss to consumers but it is likely that it will avoid costs and risks in the future.

6. Cost-Benefit Analysis of Proposed Options

In applying the cost benefit analysis, the MEU has based its approach on applying the concept of the National Electricity Objective. The NEO requires that changes are to be assessed in terms of the NEO which requires that the change must be in the long term interests of consumers.

Option A: Retaining Current Provisions and Reliance on the CCA and NER

The MEU does not support this option. We consider that the benefits of vertical separation significantly outweigh the modest (if any) benefits and increased risks to consumers of increased vertical aggregation. Moreover, the risks of co-ownership are very high and have significant potential competition risks.

Against the background of a highly concentrated energy supply industry with only three dominant players in multi-fuels, and in light of the experience of increasing potential and actual horizontal and vertical exercise of market power behaviour in the NEM, the MEU considers the risks of Option A are substantial.

In addition, consumers are very wary of 'creeping aggregation' as demonstrated in the NEM, with considerable re-aggregation of generation and retail, and hence the increased incidence of market power activities. Section 50 of the CCA (TPA then) has not protected consumer interests, and the courts cannot be wholly reliant upon as discussions are uncertain.

Option B: Revisiting the Ring-fencing Guidelines for Transmission and Inserting Relevant Components in the NEL

Whilst there may be benefits that will result from allowing economies of scale, the MEU recognises that there is little opportunity for consumers to benefit from these as there will be no pressure on the co-owning business to pass these savings on to consumers – at best consumers might get a small share of the benefit that results from external competition on the co-owning business to pass these on.

In contrast, the costs for implementing this option are small to the co-owning business but much greater on the regulator which passes its costs onto consumers.

However the risks that consumers face are significant with the potential for very large costs to consumers resulting from the exercise of the increased market power the co-owning business has.

This option is not acceptable to the MEU as the costs and risks that accrue to consumers are unlikely to be offset by the benefits consumers might gain.

Option C: Reconsidering Options Proposed in the 2007 Consultation RIS: Generation/Transmission Mechanism with a Percentage Exemption plus MW Exemption.

The MEU agrees with that the benefits outlined (page 46) in the consultation paper could result from this option, but the MEU also considers that its option (D) provides these benefits.

The risks associated with option C, however, are significant, and as the consultation paper assesses:

“This option doesn’t prevent market power concerns that may exist below the threshold level of co-ownership. Risk(s) remain that a co-owned business falling below the threshold level will still have incentives and opportunities to create market harm. This is particularly so given the:

- Nature of the electricity market
- Vulnerabilities to the exercise of generator market power that may not be determined by generator size alone (but also network congestion and availability, and the availability of interconnectors for import/exports across regions).

As the MEU had pointed out in its rule change proposal on mitigating generator market power to the AEMC, horizontal and vertical market power can and do occur in the NEM. Option C would provide a better outcome for consumers than either of options A and B but it still will enhance the scope for the exercise of both horizontal and vertical market Power. It is because of this that the MEU considers that its option D is the preferred option.

Option D: the MEU option

Option D provides the same (even enhanced) benefits that option C does, but does not require any assessment of whether any proposal falls within or outside the parameters set. This limits the costs of applying the rule.

It allows an exemption at the discretion of the regulator but places the onus of proof on the business to show that there will be little or no ability to exercise market power. This limits the costs of reviewing an application for exemption.

The MEU option requires that there be a limited life for an exemption and that divestment is mandated at the end of the exemption period. This limits the risks to consumers.

Overall, option D minimises the costs and risks to consumers. There might be some benefits to consumers through increased scale efficiencies and these would be assessed by the regulator along with an independent assessment as to the magnitude of these to consumers.

7. Response to specific questions posed

#	Question	MEU response
1	Do you believe the current CCA provisions are likely to be sufficient to prevent potential market harm resulting from co-ownership of transmission and generation businesses?	No. The reasons for this view are developed in sections 2 and 3 above
2	Do you agree with the assessment of likelihood and significance for each of the market power concerns as outlined in section 3.4?	Yes. The MEU views are provided in section 4
3	What kinds of issues should be considered to enhance the ring fencing guidelines and use of their content in the NEL, if this option is preferred?	The MEU does not support this approach and its reasons are provided in sections 5 and 6
4	What is your response to the likely costs, benefits and risks of each option as described under 'Costs and benefits of regulatory provisions to limit co-ownership in the NEM' in section 5.3?	See sections 5 and 6
5	Should a provision that limits co-ownership of generation and transmission connected in the NEM apply to all registered generators (being scheduled, semi scheduled and non-scheduled)?	Yes. Scheduled, semi scheduled and non scheduled classifications relate to operational approaches used by AEMO and AEMO assess these on very specific bases. To use classifications developed for one purpose and to apply these for another purpose is not sound regulatory practice
6	What are the benefits of co-ownership, besides diversifying risk in a business's portfolio?	The main benefit of co-ownership is that there will be economies of scale. Equally, as owners of conglomerates have experienced,

		<p>having a number of businesses with different risk and return profiles can reduce the benefits that scale provides and remove focus on one part of the business to address concerns in another part. The outcome of this is that the more profitable parts of the business do not receive the same attention as less profitable parts perhaps reducing the profitability of the profitable elements.</p> <p>The risk for consumers is that there will be no pressure on the co-owning business to pass on the benefits that scale provides.</p>
7	<p>What are the costs of prohibiting future co-ownership of generation and transmission?</p>	<p>If the MEU option D is used, the costs and risks are the smallest of all the options examined.</p> <p>The cost to consumers is that they might not achieve the benefits of scale, but they certainly will avoid the costs arising from the exercise of market power that co-ownership might impose.</p>
8	<p>Do competition concerns remain if a co-owned generator is located in a different region to the transmission network/interconnector?</p>	<p>The risk is less whilst the NEM consists of a series of connected regions but as the degree of interconnectedness increases (thereby reducing the congestion at inter-regional connectors), the concern increases. To prevent any concern it is preferable to make a blanket ban.</p>