NATIONAL GENERATORS FORUM

8 October 2012

Committee Secretary
Senate Select Committee on Electricity Prices
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir/Madam

The NGF is the national industry association representing private and government owned electricity generators. NGF members operate across all states and territories and all generation technologies, including coal-fired plant, gas-fired plant, solar, bio-waste, hydroelectric plant and wind farms.

MARKET CONDITIONS

Wholesale electricity prices, excluding the impact of carbon pricing, are lower today in nominal and real terms than they were when the National Electricity Market was established in 1998. Despite a rise in the wholesale price in 2008, due to the impact of drought conditions limiting the availability of water for electricity generation, prices have remained relatively low and declining over the past decade.

In real terms, the wholesale price of electricity is around 50 per cent in 2011-12 than in 1995-96 when electricity supply was operated by state governments (Refer to Figure 1). This figure also demonstrates the contribution of network costs and green schemes to the retail electricity price.

Demand for electricity has declined by 3.4 per cent since 2008/09 (Refer to Figure 2) due to a range of factors including: rising retail prices, improved energy efficiency and reduced industrial activity.

Since 1 July 2012, the carbon price has significantly increased the cost of production of electricity from thermal generators and increased the wholesale price of electricity by around $20/MWh. The NGF cautions against making policy conclusions based upon short-term market prices. More accurate estimates of the cost impact of the carbon price on the wholesale price of electricity will require significantly longer timeframes.

The carbon price has become the largest input cost to the production of electricity for a number of black coal generators, who have not received any compensation for the impact of the carbon price on their business.

Electricity generators are therefore facing extremely challenging market conditions which are reflected in the financial performance of these businesses (Refer to Figure 3).

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RENEWABLE ENERGY TARGET

The NGF supports the continuation of the RET and the objective of achieving at least 20 per cent renewable generation by 2020. The RET is an important component to reducing greenhouse emissions to 5% below 2000 levels by 2020 and has been effective in its objective of attracting investment into renewable generation.

The majority of NGF members are concerned that the fixed LRET target of 41 TWh/a, in light of an unprecedented reduction in electricity demand since 2008, has the potential to cause material harm to the National Electricity Market.

The LRET (41 TWh/a) was based on forecast demand for electricity in 2020 which, in light of new data, is unlikely to be realised. Since 2008 electricity demand in the National Electricity Market (NEM) has fallen from 197 TWh/a to 191 TWh/a and the forecast electricity demand in 2020 for the NEM has been reduced by 20% (from 270TWh to 217TWh).

The fixed LRET target is forcing an increase in the supply of energy into a market that has been experienced declining demand for five years.

The majority of NGF members support the RET target of at least 20 per cent of Australia's electricity supply being delivered from renewable sources by 2020 being expressed in these terms and not as a fixed TWh target for industry.

Moreover, the NGF believes that while the revised 2012 AEMO National Electricity Forecasting Report moderates the demand forecasts, they remain ambitious. The AEMO demand forecast anticipates that the current decline in demand will cease immediately and that demand will again grow each year through to 2020. This appears at odds to anticipated further increases in the regulated retail price of electricity over the next few years and recent trends in demand from major electricity users.

Government regulation that forces an increase in generation capacity in the current market will result in under-utilisation of existing generation assets and inefficient market outcomes.

MARKET POWER

The Australian Energy Market Commission is currently considering a Rule change proposal examining the potential exercise of generator market power in the NEM. The AEMC has released a draft determination finding that the NEM is workable and effective and that there is no evidence of material market power that would warrant changes to the existing Rules. The AEMC has announced an extension to the date for releasing the final determination to give it time to consider and analyse issues canvassed in some submissions to the draft determination.

The NGF believes that the NEM has delivered a highly competitive wholesale market for electricity which is demonstrated through the sustained low wholesale prices within the NEM. The NEM has performed exceptionally well in delivering a reliable supply of electricity to the grid and encouraging new generation investment when and where it has been needed.

Spot electricity prices vary between -$1000 and $12,900. As recognised by the AEMC, a thorough economic analysis of the NEM must look at trends in the wholesale and contract markets over a period of years and take into account investment responses to short periods of more volatile prices.

The NGF maintains that an analysis of the NEM prices show that the wholesale price of electricity has declined consistently for a number of years and that concerns regarding generator market power are misplaced.

OTC DERIVATIVES REGULATION

The NGF is concerned that the *Corporations Legislation Amendment (Derivatives Transactions) Bill 2012,* which has been introduced to Parliament, will impact on a range of derivatives markets well beyond the original policy intent of the G20 commitments made by the Australian Government.

We do not believe that this legislation appropriately targets the stated policy objectives and could lead to unnecessary cost increases to the price of electricity through unnecessary regulation of a well-functioning market.

We would encourage amendments to this legislation to narrow the scope of products to which this legislation applies and in doing so provide more certainty to the financial markets regarding targeted financial instruments.

Electricity derivatives were not identified as a concern warranting regulation through the Australian Government's commitments through the G20 and nor have any concerns with stability or integrity of this market been raised in further consultation.

ELECTRICITY FORECASTING

A major contributor to the rising retail price of electricity has been the investment in electricity networks (Refer Figures 4 and 5). This investment has been undertaken, at least in part, to meet highly ambitious forecasts for electricity demand which have not been realised.

The process for the development of these forecasts relied heavily on contributions from network and transmission businesses. These demand forecasts also fed into various AEMO planning and forecasting publications including the annual Electricity Statement of Opportunities. Consequently, there has been a history of ESOO forecasts showing looming supply shortfalls across the NEM when the reality has been far different.

This year AEMO published the National Electricity Forecasting using independent modelling and a consistent approach across regions. The Forecast for growth in Peak Demand has been downgraded by 36 per cent.

The NGF welcomes the contribution of AEMO in undertaking this forecasting exercise and to remove the previous inherent conflicts which facilitated forecast growth in demand that has not been realised.

While the revised forecasts are welcome they remain ambitious in the current economic climate.

The NGF has sought the publication of "bulk supply point" information to give market participants a greater level of information on the recent drivers of the fundamental changes in demand patterns in the NEM.

We consider that such information has the potential to greatly improve the efficiency of generation planning and investment decisions by giving participants some sub-regional data on historic demand side changes. Currently, generators and potential investors have no detailed data available to prepare and populate their own demand forecasting models.

The NGF is currently working with AEMO to determine the appropriate publication of this data.

Yours faithfully

Tim Reardon
Executive Director

Figure 1

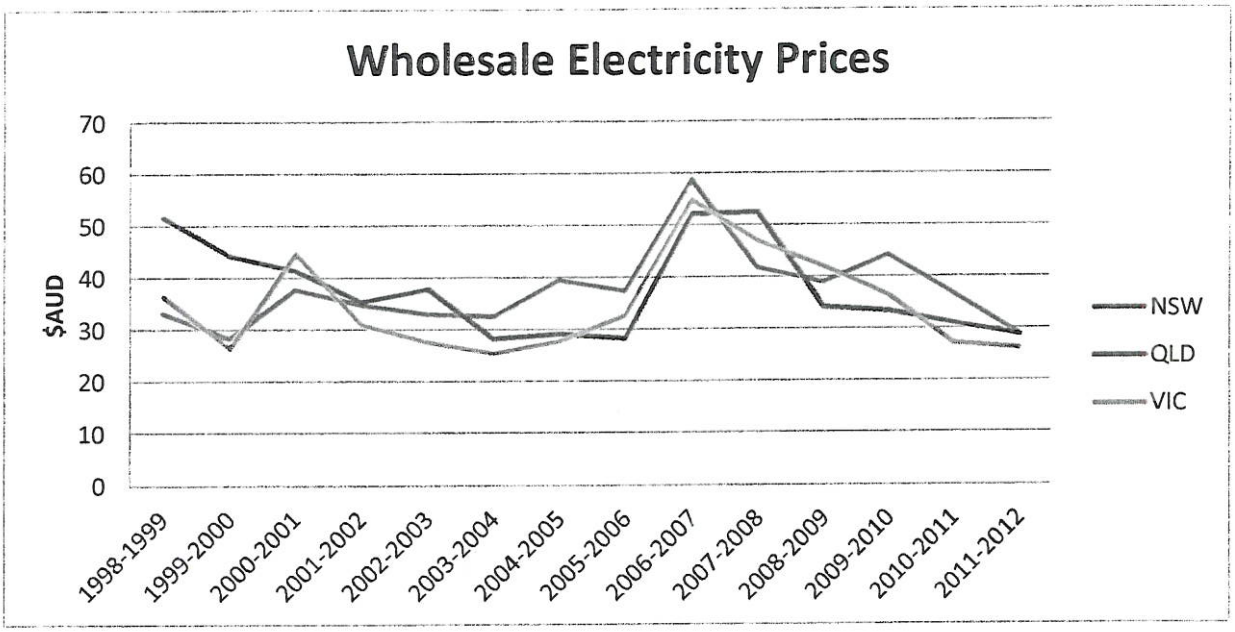

Figure 2

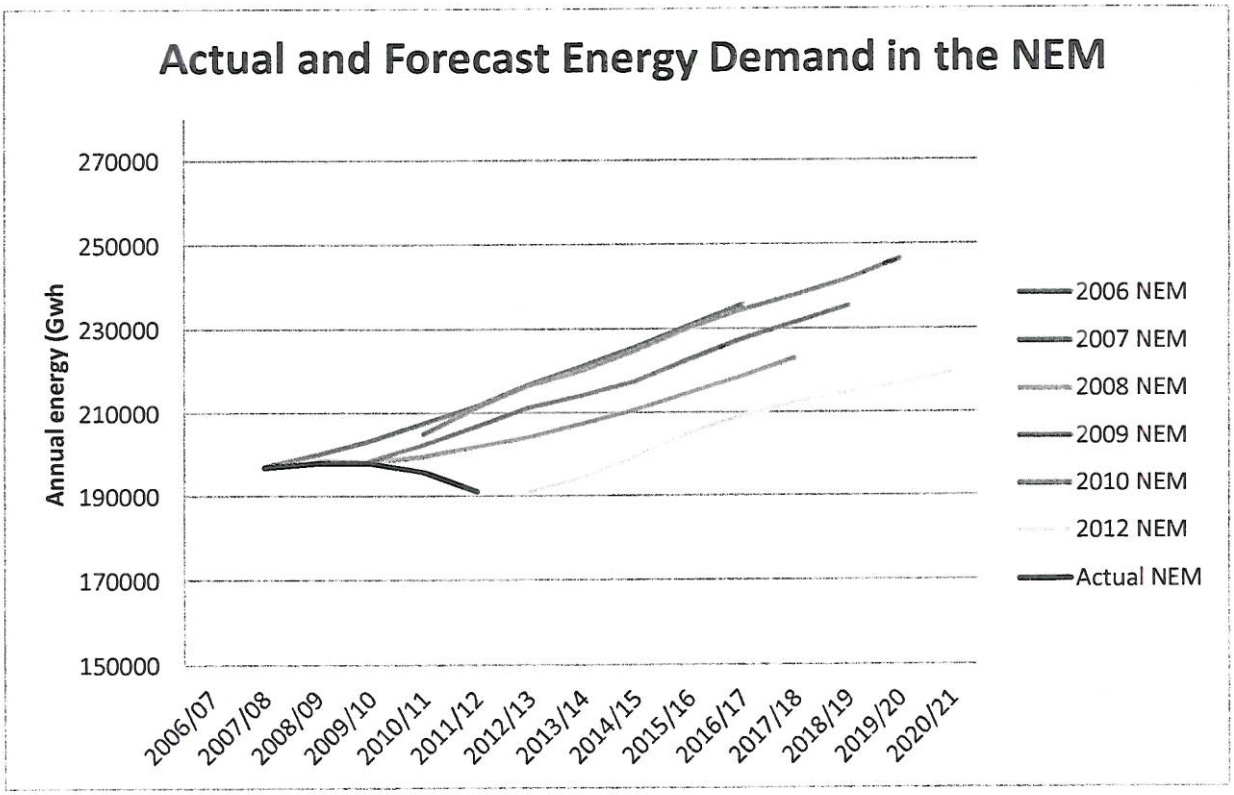

Figure 3

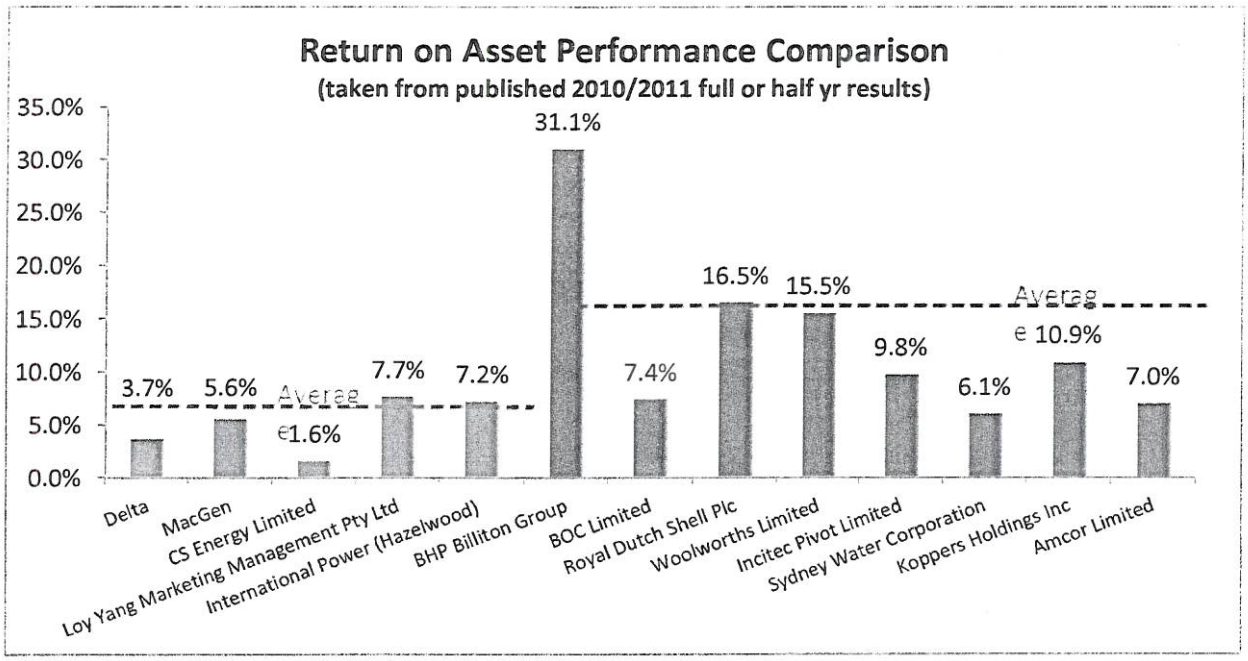

Figure 4

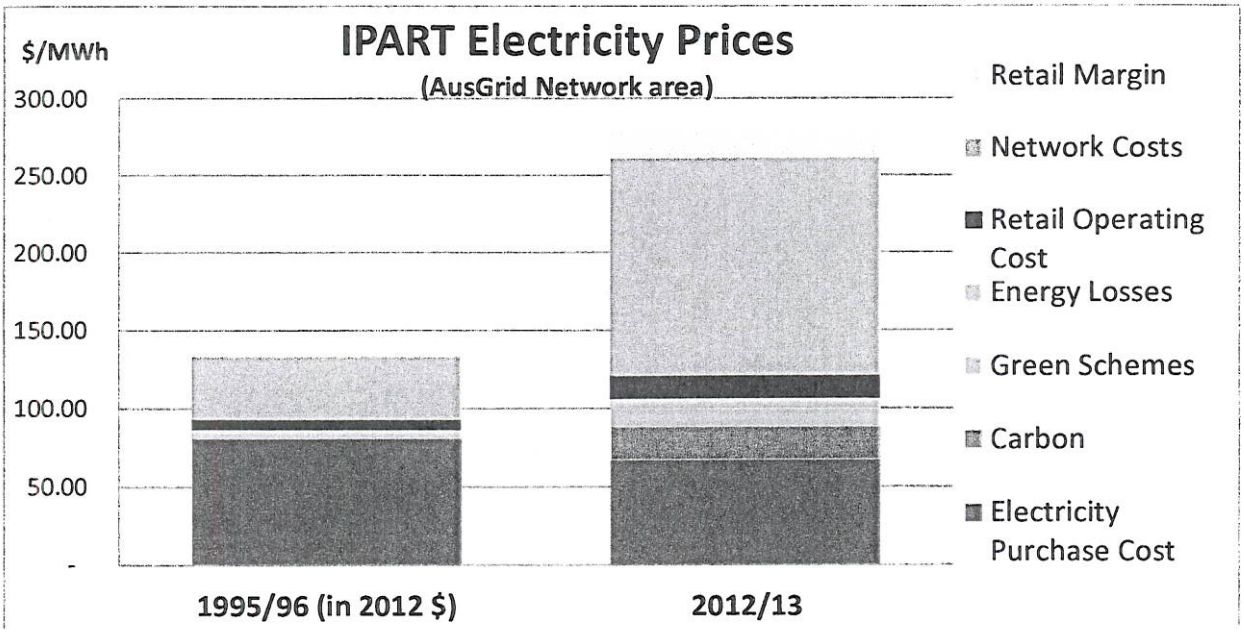

Figure 5

Regulated Electricity Prices in Queensland