



**Victoria
Energy Policy
Centre**



Victoria Energy Policy Centre
Victoria University
City Flinders Campus
Level 13,
300 Flinders Street, Melbourne
Victoria University
PO Box 14428
Melbourne Vic 8001 Australia
Phone +61 3 9919 1340
Fax +61 3 3 9919 1350
vepc.org.au

ISP@aemo.com.au
AEMO

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Dear Sir/Madam

This letter responds to your October consultation paper “Draft Competition Benefits Inputs, Assumptions and Methodology”. In that paper you are asking whether “competition benefits” should be included in regulatory investment test assessments. AEMO seems to define competition benefits as, essentially, the reduction in generation costs that may occur if the transmission augmentation encourages greater rivalry amongst generators. AEMO is asking whether these benefits should be estimated and included in regulatory investment test assessments of transmission augmentations.

Simulating market outcomes over a 25+ year future is perhaps unavoidable if trying to estimate the benefits of a transmission augmentation. Constrained optimisation models that assume that generators offer their production at their short run avoidable costs is perhaps the most straightforward approach to such modelling. But nonetheless it is problematic: the constraints are uncertain, the characterisation of the power system and market in the model is invariably highly simplified and stylised and of course generators’ short run avoidable costs are uncertain. Using different assumptions on the offers that generators actually make (or how competition actually occurs) does not solve the underlying modelling problems or provide any greater certainty on future outcomes.

From our practical work in this area –constrained optimisation modelling of the NEM – it is a trivial computational matter to work out generation dispatch and market clearing prices using whatever assumption on generation bids one wishes to. Likewise programming a game theoretic algorithm is usually a trivial extension – although the simulation might be stochastic, the model is deterministic. Computation is not the limitation. The problem lies with the model specification, the way the market is assumed to operate and in deciding the generation offers to assume in the various computations. Even short run marginal/avoidable costs are not knowable with any degree of



certainty. How then to plausibly suggest how generators with some level of ability to make, not take, prices might be expected to bid over a 40 year horizon with or without the transmission augmentation in question?

In other words, while “competition benefits” are easy to conceptualise they can not be estimated with any reasonable level of confidence. Likewise any conjecture that a transmission augmentation will provide competition benefits by stimulating competition is not in any way provable. No amount of effort in trying to develop the metaphorical mouse trap, will be able to catch this mouse.

The real question AEMO is asking is therefore not one of “inputs, assumptions and methodology”. Rather, the relevant question is primarily a question of incentives and response to those incentives: what are the incentives on the transmission entity seeking approval for its augmentation, on the authorities that vet the proponents’ claim or the incentive on interested parties with vested interests? And, what is the respective ability of those parties to promote their own interests in the regulatory process?

The transmission proponent obviously has an incentive to big-up the benefits of its proposed projects – it has an incentive to build and own those projects and wants to convince regulators to allow them to impose the costs of those projects on consumers. Regulators – and in this area it includes AEMO and the AER – may in principle be motivated by the public interest but in reality are fallible and can be expected to be susceptible to political and peer-group pressure, insularity and siloed thinking and the desire for the quiet life. Interested parties might be expected to line-up for or against the project depending on how they perceive it will affect their interests.

Do these parties have an equal ability to promote their interests? Clearly not: the transmission proponent has far greater financial resources than any other party, it also has superior technical skills, access to data and knowledge of the system. And, most importantly, its interests are concentrated: it has good reason to fight hard to get what it wants.

What about the regulators (including AEMO)? In some areas the technical capability gap relative to the proponent may not be large, but the regulator’s resources are spread over many projects it will be involved in assessing. Importantly, as the approval process is currently set out, it is the regulator that reacts to the proponent and so the proponent, not the regulator, tends to drive the discussion. For all these reasons, the regulator can be expected to be in a weak position in trying to push back against over-wrought claims by the proponent.

Interested parties are even more disadvantaged in their access to technical skills and financial resources. Might it be unreasonable to conclude that in the long history of “consultation” in network regulation, consumers’ critiques are seldom substantive?

Bringing these points together leads me to the conclusion that inviting transmission proponents to quantify “competition benefits” is likely to be an invitation to rent seeking that regulators and interested parties can be expected to be largely ineffective in stopping.



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Rather than inviting transmission proponents to quantify the competition benefits of their proposals I suggest instead that transmission proponents be invited to provide evidence of market power that they believe their transmission augmentation will reduce. This evidence could take the form of inductive and/or deductive reasoning on how generators compete and how the proponent believes that its transmission augmentation would change this in a way that reduces the aggregate cost of production.

How should AEMO act in response to such submission? If AEMO considers that this evidence and argument is not plausible, it might say so and the matter then take its course through the relevant approval processes accordingly. If AEMO considers that the evidence is plausible AEMO should consider exploring the option of referring this to the Australian Competition and Consumer Commission for their consideration and advice. Perhaps this might lead the ACCC to take action through its powers to enforce consumer law. Alternatively the ACCC may reject the arguments or it may refer the issue to the AEMC for consideration of changes to the way that the wholesale market is designed or operated.

This is not more than a rough sketch of an alternative administrative process that I think could deal more effectively with the (possible) competition benefits of transmission augmentation. My idea aims to ensure that network service providers are able to make the argument that there are competition issues that they believe their augmentation will address, but that this argument is assessed in a reasoned and transparent way and if sufficiently compelling to AEMO to merit further scrutiny, it should then be judged by a competition authority that is able to consider a wide range of possible solutions, not just transmission augmentation. I commend the idea for your further consideration.

Yours faithfully,

Professor Bruce Mountain
Director