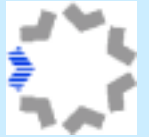


The National Electricity Market under National Competition Policy

Ed Willett, Executive Director,
National Competition Council

Outline



- ◆ Development of the National Electricity Market (NEM)
- ◆ Potential NEM problems and issues.
- ◆ Similarities and differences to California.
- ◆ The path forward.

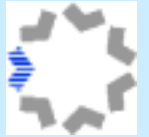
Key NEM components



Objectives for a fully competitive NEM:

- ◆ the ability for customers to choose the supplier, including generators, retailers and traders, with which they will trade;
- ◆ non-discriminatory access to the interconnected transmission and distribution network;
- ◆ no discriminatory legislative or regulatory barriers to entry for new participants in generation or retail supply; and
- ◆ no discriminatory legislative or regulatory barriers to interstate and/or intrastate trade.

Key NEM components



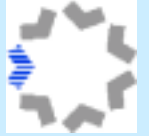
1996 CoAG timetable amendments:

- ◆ have the National Electricity Code (the Code) accepted by the (ACCC); and
- ◆ fully implement the market arrangements specified in the Code by early 1998, including NEMMCO and NECA assuming full operational responsibilities for the national market.

Progress to date

- ◆ The NEM commenced operation in December 1998.
- ◆ Jurisdictions currently participating in the NEM are New South Wales, Victoria, Queensland, South Australia and the ACT.
- ◆ Tasmania is to join upon completion of the Basslink Interconnector with Victoria in 2003.
- ◆ Progress against commitments related to the establishment of the NEM has generally been good.
- ◆ But there are some aspects of the current market arrangements which may be acting to limit competition in the NEM.

Outstanding issues



- ◆ Improvements to the existing market arrangements are an ongoing requirement to facilitate the establishment of a fully competitive NEM.
- ◆ The Council is concerned that impediments to competition may exist, or emerge, in relation to:
 - the transitional and institutional arrangements,
 - the structure of the generation market,
 - the framework underpinning interconnect developments, and
 - the implementation of full retail competition.

Derogations



- ◆ In looking at derogations for the third tranche assessment, the Council will consider their purpose, their outcomes in relation to the aims of the NEM, and the likely effects of their removal.
- ◆ In general, the Council believes there should be no need for transitional measures beyond December 2002.
- ◆ A possible exception is the introduction of full retail competition, where there have been some delays to the timetable. Any additional or extended derogations would need to satisfy a robust public interest case.

Vesting contracts



- ◆ The intention was that all vesting contracts would cease by 31 December 2000.
- ◆ The Council accepts that there may be a case for continued management of the risks faced by retailers if there are delays in making retail competition effective.
- ◆ However, it is concerned that vesting contracts place major constraints on the behaviour of generators and retailers, and so limit the full application of market arrangements.

Institutional arrangements



- ◆ Experience to date suggests that there may be some weaknesses in the institutional framework.
- ◆ While jurisdictions have examined governance and liability arrangements, the Council considers that a broad examination is also needed of roles and responsibilities in the areas of market operations, market development, Code change and regulation.

Structure of the market



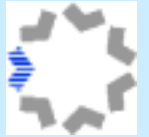
- ◆ The Council would be highly concerned if there was any move to reduce the number of generating companies in any jurisdiction.
- ◆ In particular, it would regard any reduction in the number of generating companies as undermining structural reform commitments, where generators are in public ownership.
- ◆ The Council would also be concerned at any increase in government intervention in market outcomes, particularly those dealing with the type or level of capacity.

Interconnects



- ◆ The Council will be considering the arrangements underpinning the development of both regulated and unregulated interconnects as a matter of priority in the third tranche assessment.

Full retail contestability



- ◆ The Council believes that the implementation of full retail competition is an essential component of the electricity reforms. Both the timing of, and the approach to, the implementation of full retail competition will be essential to ensure that the NEM objectives are met.
- ◆ In the third tranche assessment, the Council will want to ensure that the opening up of the market to competition to date is proving effective.

Some differences to California



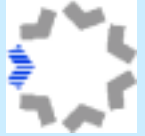
- ◆ Long term electricity supply contracts were discouraged in favour of spot deals.
- ◆ High regulatory barriers to entry in generation, especially in environmental regulation.
- ◆ Growth in electricity demand grossly underestimated.
- ◆ Retail price regulation without wholesale price protection.
- ◆ Not enough focus on competition.

Some similarities to California



- ◆ Rising demand relative to supply leads to higher electricity prices.
- ◆ Inadequate interconnection arrangements.
- ◆ A shift away from long-term contracting in generation and possible manipulation of spot markets.
- ◆ Generation too concentrated in some regions of the NEM.
- ◆ Consumers don't shift demand in response to price rises.

The path forward



The NEM is not the same as California, but we wouldn't want to ignore any lessons.

NEM arrangements need to ensure:

- ◆ right incentives for construction of regulated and unregulated interconnection;
- ◆ right incentives for new generation;
- ◆ right incentives for utilisation of existing generation capacity;
- ◆ sound institutional arrangements for system operation (NEMMCO) and Code changes (NECA and the ACCC);
- ◆ that contestibility works, including the roll-out of full retail contestibility.

All these things are on the agenda for further development of the NEM arrangements, if required.

Questions?.

For Further Information;

National Competition Council

Ph: (03) 9285 7474 Fax: (03) 9285 7477

Website: www.ncc.gov.au

