

Electricity Deregulation – The Juggernaut Continues

For the last few years I have been contributing annual articles to this magazine on the progress of the energy deregulation processes.

The first few articles looked at the mechanics of the deregulation process and operation of the market. As deregulation began to unwind there was more of a focus on the net benefits, or lack thereof, brought by the process. By now, virtually all of the East Coast electricity markets have been deregulated and many large consumers are entering their seventh year of ‘deregulation’. Thus we would expect that the process had settled down, trends were becoming apparent and the process was generally well understood.

Interestingly enough, we are probably wrong on all accounts. I have just had the privilege of chairing an energy conference and I can assure you that there is still considerable confusion amongst many large users. What was even more surprising was the spread of ‘expert opinion’ when it came to explaining and predicting market behaviour.

Lets start with the good news. Despite dire predictions there was no power shortage in Victoria or South Australia this summer. Both states experienced record demands and coped without any problems, notwithstanding short-term gas production problems in South Australia. What is even more perplexing is the low pool prices in February. Temperatures across the National Electrical Market (NEM) were relatively high over February; some record demands were set along with some record or near record low prices. The average pool price in Victoria, NSW and Queensland over February was under \$20/MWh with South Australia at \$23/MWh. Perhaps this is a sign that the generators are heavily contracted and will bid low in order to get despatched. On the other hand, it may be a sign that stable market behaviour is still emerging and largely unpredictable.

More good news, it looks like retail prices are also beginning to soften for end users. It doesn't look like they will get down to the record lows experienced in Victoria a few years ago, but it does look like the prices have dropped several dollars per MWh with even greater drops in South Australia.

Now behind every silver cloud there is a dark lining. Most, if not all, of the generators are complaining that these low prices are not giving them sufficient return to service their debt and meet running costs. Thus they are not investing in the new plant that many people believe will be required by about 2006. Many people expect that load growth will outstrip supply across significant areas of the NEM by about 2006 and rotational load shedding will be needed to balance the supply / demand equation.

Proponents of this line of thought then predict ‘gloom and doom’ from about 2006 until the government steps in and underwrites new generation. Alternatively, the pool price might bounce up high enough to encourage more private sector investment. I must admit, this is the argument I often develop. Much like the biblical seven years of plenty followed by seven years of famine.

Underpinning the argument are perhaps the two most robust assumptions that can be made about electricity.

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Electricity use is relatively price inelastic and electricity cannot be stored. Thus, prices will remain low until there is a genuine shortage at which time prices will significantly move up in order to fund the new investment required to meet supply. There will be several years of ‘famine’ and high prices until the new plant comes on line followed by several years of plenty and low prices as the market responds to the now adequate levels of supply. Virtually a state of bipolar stability.

Of course, there are any number of industry analysts who can assure us that there will be no power shortages. Their argument is that there is adequate new investment, especially in relatively small power stations and renewable power stations coupled with a demand side response. Only time will tell.

The newly deregulated electricity is also undergoing some pretty significant soul searching. Most, if not all of the major participants are not happy with the regulatory regime. There are claims that it is overly complex, overly regulated and in turn creating a market that is too unpredictable, too complex and unattractive to investors. A number of options to deal with this issue are currently under discussion, including the idea of a single national regulator, possibly under the auspices of the ACCC.

Over the last few years we have also seen environmental issues ‘bolted onto the NEM’. On a federal level, we have the Mandatory Renewable Electricity Target (MRET) scheme. This objective of this scheme is to increase our proportion of renewable electricity from 10%, as it was a number of years ago to 12% by 2010. Initial expectations are that this would require an additional 9,500 GWh of electricity, and the target has been set at 9,500 GWh. However the effect of normal load growth means that this additional 9,500 GWh will not increase the proportion of renewable electricity to 12%. Thus, there are a number of people who are now arguing that the 9,500 GWh target should be increased.

The cost of complying with the MRET legislation is currently about \$0.5/MWh with an expectation that this will rise to about \$1/MWh over the next few years.

Various state governments have also added their own environmental requirements to the electricity market. NSW have their Mandatory Greenhouse Benchmark Scheme that is targeting a 5% reduction in 1990 per capita emission by 2007. The scheme was introduced on January 2003 and it is expected that the scheme will add between \$1/MWh and \$2/MWh. As of January 1, 2005 Queensland will be requiring that at least 13% of the electricity sold in their state be sourced from gas or renewable generation. No doubt Victoria is not far behind and there is a general expectation that they will implement an environmental program for inclusion in the electricity supply requirements.

This begs the obvious question, why can't the states agree on a common program that will bring maximum benefit for the least cost without the administrative headaches of understanding, managing and complying with a plethora of state based regulations. I have seen no argument to demonstrate that the current approach is the ‘least cost’ and no rationale for burdening the industry with differing state based regulations.

Lets hope some common sense prevails.