

# Community Electricity

## Submission in Response to ERA Public Consultation

### 2012 Wholesale Electricity Market Report to the Minister for Energy

#### Standing

Community Electricity is a member of the Independent Market Operator's Market Advisory Committee (Market Customer) and the Economic Regulation Authority's Technical Rules Committee.

Community Electricity is a provider of Electricity Retail Services and Market Consultancy.

#### Introduction

The Reserve Capacity Mechanism is the principal focus of the 2012 Wholesale Electricity Market Report Discussion Paper. In the following we address the key themes of the Discussion Paper, followed by separate responses to each Discussion Point

#### Key themes

##### The Reserve Capacity Mechanism

The IMO concluded an extensive review of the Maximum Reserve Capacity Price in 2011, and the conclusions of that review were implemented in the 2012 capacity cycle. The Authority's innovative Bond Yield approach to calculating the regulated Debt Premium of the Weighted Average Cost of Capital was also recently upheld and the IMO is using that approach in the 2013 cycle.

The IMO is also nearing conclusion of its 5-yearly review of the Reserve Capacity Mechanism which, over an 18 month period, has developed proposals to improve the sensitivity to market conditions of both the administered capacity price and capacity refunds for non-performance. Proposals have also been developed to improve the utility of Demand Side Management (DSM) capacity, and to improve the availability of generating plant by 'recycling' capacity refunds to compliant generators rather than to market customers. Community Electricity has participated in this review and supports the conclusions and process of that forum, the implementation stage of which will include full public consultation and assessment of the proposals relative to the Market Objectives.

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## Government intervention and the amount of Excess Capacity

While the Market Rules also prioritise reliability of supply, this is separately also a political imperative that drives Government intervention to ensure that available capacity always exceeds demand. Recent examples of Government intervention include the refurbishment of the 240MW Muja AB coal plant and the subsidising of some 200MW of residential solar PV.

Noting that power station developments take in the range 1 to 4 years from financial commitment to commissioning and are generally sized in the region of 1 to 2 years' of traditional system growth (~125MW per year), it should therefore be expected that the power system would always be in surplus and never in deficit. That said, the present challenge is partly to decide whether the present ~15% excess capacity is too much and if so, to ensure that there is a price signal to stop it increasing. The other part of the challenge, which is potentially more significant and which is not actively discussed because of the present excess, is to ensure that the administered "build" signal is strong enough when the excess quantity diminishes toward parity. In this regard, it should be noted that the present excess could potentially be absorbed within a few years by the planned retirement of Verve Energy's 365MW Kwinana C coal plant in combination with the addition of new resource loads when Western Power's Mid West Transmission Line is completed.

## Minimising the long term cost of electricity

The Wholesale Electricity Market (WEM) Market Objectives seek, among other things, to minimise the long-term cost of electricity supplied to customers. We would emphasise the focus on the 'long term' and on 'electricity', being the combination of capacity and energy.

From the perspective of the consumer, the capacity component of the cost of electricity relates to the provision of infrastructure, which is sunk 2 years in advance of availability. In real time, reliability is defined by the available plant and is difficult to change, with the cost of energy being the key uncontrolled determinant of the cost of electricity. In general terms, coal fuel (inclusive of carbon) is cheaper than gas fuel and both are much cheaper than diesel. The issue of retirement of ageing capacity therefore depends on its fuel type. While the benefits of an unreliable diesel peaking plant are difficult to justify, an unreliable coal mid merit plant is potentially useful for reducing the cost of energy and improving fuel diversity.

## Quality of Capacity

In addition to the quantity of capacity, there is the issue of its quality. In particular, the quality of the capacity sources from DSM and from Intermittent Generation (primarily wind) was reviewed in 2011 and a new method of assessing the capacity contribution of Intermittent Generators was implemented. This has led to a substantial reduction (~90MW over 3 years) in the capacity supplied by Intermittent Generators. In addition, the current proposals to 'harmonise' DSM are expected to reduce that sector's perceived contribution by around 20% (100MW).

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## Capacity auction

The relative merits of replacing the administered capacity price by a compulsory auction are also a current issue. We support the Lantau Group's conclusion, via the Reserve Capacity Mechanism Review, that this would impair achievement of the Market Rules by way of the 'zero or infinity' problem. That is, in times of excess capacity, the marginal price would be zero and in times of shortage, it would be infinity (unless capped, in which case the new entrant faces downside with little upside). In this regard, we would note that a zero price would likely lead to participant bankruptcy and non-delivery of the capacity. Equally, we suggest that achievement of minimal electricity prices requires an orderly price evolution over the long term, and should be assessed on the basis of the average price over the long term.

## Discussion Point 1

*Stakeholders are invited to comment on how the Market Rules may be improved so that the Reserve Capacity Auction provision can be utilised by the IMO for the procurement of any capacity shortfall in meeting the Reserve Capacity Requirement and whether the Bilateral Trade Declaration of capacity should be made as a binding commitment between Market Participants similar to the Bilateral Submission in the energy market of the WEM.*

## Reserve Capacity Auction

As stated in the Discussion Paper, the Market Rules provide for a Capacity Auction conditional on there first being a shortfall of Certified Capacity relative to the Reserve Capacity Requirement. While no auction has been held to date, the Market Rules provide that when an auction is held, the Clearing Price serves as the Reserve Capacity Price for that year. Cleared Capacity is also entitled to enter into a 10 year Special Price Arrangement in which the successful proponents are given an option to receive for each Capacity Year either the Auction Clearing Price or the prevailing Reserve Capacity Price.

From the perspective of a power station developer, the Special Price Arrangement is an excellent means of underwriting a power station via the credit-support of the entire electricity market, with Market Levies across participants making good any relevant financial default. The disadvantage to developers is the requirement that the power station be Capacity Certified and free from bilateral encumbrance as a precondition for participation in the auction. Given that there is no guarantee that the auction will occur, the developer is therefore required to risk the loss of a substantial development cost if it does not. There is also the further disadvantage that Capacity Auction offers are capped at the administered Maximum Reserve Capacity Price, which is an annual representation of the expected cost of building a benchmark power station.

From the perspective of the Market Objectives, the purpose of the auction is to 'discover' the best price of the next power station, and as such the process needs to be liquid with minimal barriers to participation. However, the practical reality is that power station sizes are 'chunky' and participants necessarily have to accept a high risk (which demands a high return) on auction participation. It is therefore likely that any auction would comprise only one participant bidding at the price cap.

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Community considers that as the auction is triggered by a capacity shortfall, and as the market currently contains ~15% excess capacity, it is very unlikely that an auction will take place in the foreseeable future. We therefore consider that the issue of perceived improvements of a process that has never taken place is not a priority. That said, however, we consider that the efficacy of the auction process would be improved by removing the present entry barrier to auction participation, and that this is important in order to prevent a call of (expensive) Supplementary Reserve Capacity during shortfall conditions. While the specifics of this would require industry review, improvements could possibly include, for example, advanced notice of an IMO-mandated auction. For example, whereas the capacity cycle is annual and 2-years ahead, the IMO could, say 3 years ahead, have discretion to mandate that an auction will be held in the N+1 cycle for procurement of a nominated quantity of capacity. Another possibility could be to replace the auction altogether by a competitive tender to build a peaking station to be owned, for example, by the market and operated by System Management. Such an arrangement could provide capacity to the market at no cost after the end of the contract term.

## Bilateral Trade Declaration

Power station developments are capital intensive and it is important that the Market Rules facilitate both effective risk management in the event of offtaker default and removal of any need to match the bilateral contract term (generally less than 15 years) with the economic life of the station (potentially 30+ years). It is also necessary to facilitate the transaction of 'overs' and 'unders' as the offtaker demand will vary from year to year, and it is generally not possible to accurately specify the Individual Reserve Capacity Requirement of a consumer beyond the current Capacity Year. Developers would generally also prefer to contract with a portfolio of offtakers, enabling diversity of prices, contract terms and credit standings.

The Market Rules facilitate the following broad approaches for developers to underwrite their project financing:

- a A long term bilateral contract with a substantive offtaker of good credit standing (such as the State-owned Synergy and Water Corporation); or
- b A Special Price Arrangement with the IMO <sup>NOTE1</sup>; or
- c A de-facto option to transact with the IMO (representing 'the market' as a whole) as and when it chooses to do so; or
- d The possibility of an evolving portfolio of short term bilateral contracts with lesser credit standing, but back-stopped by the IMO option in iii);

Note - As discussed above, an auction has never taken place, is very unlikely to take place in the near future, and would in any case be likely to be illiquid.

On grant of Capacity Certification, holders have the choice of either participating in an auction or declaring an intention to bilaterally trade their capacity, where the latter includes as a subset the ability to transact surpluses (or indeed the entire quantity) with the IMO at the Reserve Capacity Price. Where a developer chooses to Bilaterally Trade, its capacity is unencumbered and able to contract on suitable terms as a means of hedging against future variation of the Reserve Capacity Price. In this case, suppliers wishing to protect themselves against low prices, and buyers wishing to protect

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themselves against high prices can ‘meet in the middle’, whilst the supplier retains the option of selling to the IMO in the event of buyer default.

At present, there is no imperative for the developer to contract if it considers that the IMO price and expected evolution is conducive. If the developer was compelled to contract, it would be at the mercy of the buyers who could arbitrarily refuse to contract. If sellers were to be compelled, they would either not build in the first place, or there would have to be a reciprocal obligation placed on buyers in order to restore the balance of contracting power.

While contracting could be promoted through penalties applied to the Reserve Capacity Price (increases for buyers and decreases for sellers), there are other ways to achieve this with less interference. The approach being developed by the IMO is that of increasing the responsiveness (volatility) of the Reserve Capacity Price to the balance of supply and demand.

Community considers that it is vital that power station developers be able to manage their financial risk by ‘dipping’ into and out of the option to sell all or part of their capacity to the IMO without an imperative to bilaterally contract. Consequently, we consider that the Bilateral Trade Declaration should not be made a binding commitment.

## Discussion Point 2

*Stakeholders are invited to comment on whether there should be a limit set for the amount of Capacity Credits that the IMO can procure in excess of the Reserve Capacity Requirement and if so, on what basis this limit should be determined.*

Community considers that this discussion point is based on the presupposition that the present excess capacity has arisen as a result of uncapped capacity procurement by the IMO in combination with an attractive Reserve Capacity Price.

The following table lists the Reserve Capacity Price and the quantity of new capacity procured as a function of Capacity Year. The table also indicates Community’s understanding of how this new capacity was underwritten.

In particular, the term “State” is intended to cover stations that were constructed in response to Government Policy by the State-owned enterprises Synergy and Verve Energy, be it via:

- a the Displacement Mechanism of the former Vesting Contract between Synergy and Verve; or
- b in response to the risk mitigation measures taken in response to the Varanus Island gas supply interruption in 2008; or
- c climate change mitigation measures (procurement of wind energy and incentivisation of residential Solar PV).

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Reserve Capacity Price and the quantity of new capacity procured as a function of Capacity Year

| Capacity Year                                     | 09-10      | 10-11      | 11-12      | 12-13      | 13-14      | 14-15      | TOTAL       | %          |            |
|---|------------|------------|------------|------------|------------|------------|-------------|------------|------------|
|   | \$         | \$         | \$         | \$         | \$         | \$         |             |            |            |
| RCP (\$/kW/year)                                  | 108        | 144        | 132        | 186        | 178        | 122        |             |            |            |
| Change in Total Certified Capacity (MW)           | 537        | 122        | 235        | 502        | 91         | -47        | <b>1440</b> |            |            |
| Residential Solar PV (negative load MW)           |            | 100        | 100        |            |            |            | <b>200</b>  |            |            |
| <b>Net Change in Supply - Demand Balance (MW)</b> | <b>537</b> | <b>222</b> | <b>335</b> | <b>502</b> | <b>91</b>  | <b>-47</b> | <b>1640</b> |            |            |
| <b>Power Stations</b>                             |            |            |            |            |            |            |             |            |            |
| Perth Energy                                      |            |            |            |            |            |            |             |            |            |
| Kwinana   | Private    | 105        |            |            |            |            |             |            |            |
| Merredin Energy                                   | Private    |            |            | 80         |            |            |             |            |            |
| Tesla   | Private    |            | 10         | 30         |            |            |             |            |            |
| <b>Total Private</b>                              |            | <b>0</b>   | <b>105</b> | <b>10</b>  | <b>110</b> | <b>0</b>   | <b>225</b>  | <b>14%</b> |            |
| Bluewaters 2                                      | Public     | 216        | -          | -          | -          |            |             |            |            |
| Newgen Neerabup                                   | Public     | 330        |            |            |            |            |             |            |            |
| Kwinana A   | (Retire.)  |            | -216       |            |            |            |             |            |            |
| Kwinana HEGT                                      | Public     |            | 184        |            |            |            |             |            |            |
| Colgar Wind Farm                                  | Public     |            | 90         |            |            |            |             |            |            |
| Vinalco   | Public     |            |            | 220        |            |            |             |            |            |
| Residential Solar PV                              | Public     |            | 100        | 100        |            |            |             |            |            |
| <b>Total Public</b>                               |            | <b>546</b> | <b>100</b> | <b>158</b> | <b>220</b> | <b>0</b>   | <b>1024</b> | <b>62%</b> |            |
| Demand Side Management                            | Private    | -29        | 55         | 107        | 194        | 45         | 24          | <b>396</b> | <b>24%</b> |

Note: developments below 10MW are not included

It is seen that of the 1,640MW increase in capacity over the last 5 years, 1,440MW was Certified Capacity and the remainder 200MW of uncertified residential Solar PV. Only 225MW (14% of the total) was contributed by private projects - all of them diesel-fired peaking stations. A further 24% was contributed by Demand Side Management, which is understood to involve relatively low capital cost. The remaining 824MW (62%) was contributed via State underwriting, which did not depend on the capacity price. [This includes 200MW of 'negative load' contributed by the State's incentivisation of residential Solar PV]. This same set of facts may also be perceived as private projects contributing at most only 225MW (30%) of the prospective 2013-14 excess capacity of 775MW, as uncharitable as that view may be.

It should also be remembered that the power system has historically grown at 3 to 4% per year and it has only recently been realised that it is transitioning to an alternative low growth paradigm characterised by solar PV penetration, energy conservation, and delayed resource project development. This has contributed materially to the present excess capacity condition through the need to unwind excessive load forecasts that would have encouraged the influx of new generation.

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Community notes that the IMO's existing Reserve Capacity Mechanism Review has developed proposals to make the Reserve Capacity Price more responsive to the balance of supply and demand, which would penalise excess capacity more emphatically than is currently the case.

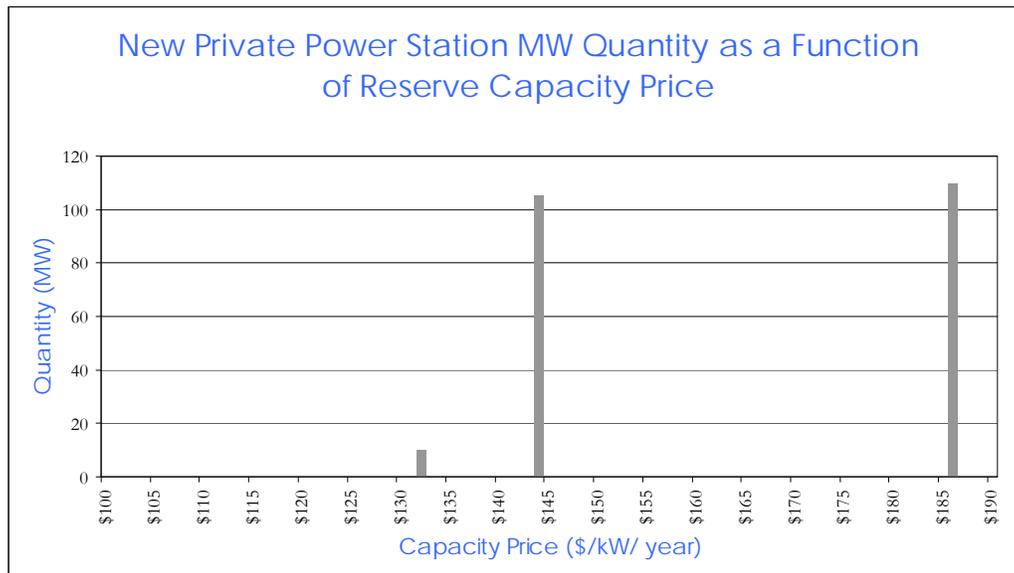
On this basis, Community considers that it is not appropriate to cap the quantity of new capacity entry, at least in respect of private capacity depending on the Reserve Capacity Mechanism.

## Discussion Point 3

*Stakeholders are invited to comment on the effectiveness of the Reserve Capacity Price that has been set using the administrative formula with reference to the Maximum Reserve Capacity Price and the Excess Capacity Adjustment and whether an alternative calculation formula should be explored.*

As stated in the Discussion Paper, the Reserve Capacity Price has since market commencement been set administratively. The process involves first determining the Maximum Reserve Capacity Price (MRCP) that may be offered into an auction, should one take place. The MRCP is then adjusted by an arbitrary factor of 0.85 and then proportionately reduced according to the quantity of Excess Capacity that is actually procured.

Regarding the efficacy of the price signal provided by the Reserve Capacity Price, the quantity of capacity procured via new power stations is shown as a function of Reserve Capacity Price in the following graph.



While there is insufficient data to form a convincing view, noting that the IMO flagged a reduction in the Capacity Price well ahead of the fall to \$178/kW in 2014-15, the graph may indicate that there is a hurdle price of around \$140/kW, below which only boutique developments (and DSM, though not shown here) can proceed.

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On this basis, Community considers that the evidence suggests that the administered price has been fit for purpose with the exception of the two extreme years as discussed earlier. However, we consider that the evidence also indicates that the administered price may not be sufficient to motivate the entry of new plant under the current economic and regulatory environment. In particular, there is a case that because of the Global Financial Crisis, the regulated Weighted Average Cost of Capital is lower than can realistically be achieved by developers. In addition, there is a perception, albeit erroneous in our view, of regulatory risk because of the recent substantial reduction in the regulated Maximum Reserve Capacity Price.

While Community supports the present approach, we also consider that the administered price formula needs to be reviewed from the perspective of ensuring that the price sufficiently increases in a timely fashion when new capacity is needed. Community supports the Reserve Capacity Mechanism Review currently being conducted by the IMO and supports that group's recommendation to increase the formula's sensitivity to the balance of supply and demand.

## Discussion Point 4

*Stakeholders are invited to comment on Lantau's proposal for changing the Reserve Capacity Price calculation formula in the Market Rules.*

Further to the above comments in response to Discussion Point 3, Community supports the Reserve Capacity Mechanism Review currently being conducted by the IMO, which is substantially based on the Lantau Proposals. We understand that review is now winding down and progressing to public consultation on its recommendations, and we support this as the optimal venue for this issue.

## Discussion Point 5

*The Authority invites stakeholders to comment on the value provided by DSM under the current market design and the cost of DSM to the market. The Authority also invites stakeholders to comment on whether alternative treatments of DSM could provide a more cost effective way to the market for the efficient use of DSM.*

Community Electricity considers that DSM is a principal strategy for achieving Market Objective e) to manage the amount of electricity used and when it is used. We also consider that DSM proved its utility during the Cyclone Carlos gas supply interruption and we consider it an important means of facilitating increased value for money (lower net cost – Market Objective d)) for electricity consumers via the fact that a large proportion of the cost of DSM is passed through to them as its providers. This latter point is particularly important as it delivers price signals to consumers to facilitate strategic consumption decisions.

The value of DSM and the operational obligations placed upon it is a second principal feature of the IMO's current Reserve Capacity Mechanism Review. That review has developed proposals to 'harmonise' the performance obligations placed on DSM so as to make it of equal value to Scheduled Generation in return for an equal payment. These

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proposals include substantially increasing the availability required of DSM, decreasing the hours of prior notice and improving ‘visibility’ of the available capacity and the management of its dispatch. The IMO judges that these more onerous requirements will reduce the quantity of DSM offered to the market by around 100MW (20%).

We understand that the IMO’s Reserve Capacity Mechanism Review is now progressing consultation and implementation of its harmonising proposals, and we support this as the optimal venue for this issue. We would also add that the wholesale market is ultimately backstopped by the ability to call for Supplementary Reserve Capacity (SRC), which would be needed in the event of non-delivery of new capacity. Not only has this happened previously, but new generators are frequently late in commissioning to the extent of substantial paying capacity refunds. There is also the possibility that existing generators could suffer extended forced outages due to both mechanical failure and fuel supply disruption. On this basis, we perceive a thriving and professional DSM sector to be an important feature of the supply and demand dynamic.

## Discussion Point 6

*Stakeholders are invited to comment on the application of clause 4.11.1(h) of the Market Rules and any appropriate modification that may be required to improve its effectiveness.*

As described in the Discussion Paper, Market Rule 4.11.1(h) empowers the IMO to deny capacity certification to an in-service plant on the grounds of its reliability record.

Community Electricity supports the principle that certified capacity should provide the service that it is being paid for, and that a systematic total outage rate in excess of 30% is, on the face of it, not acceptable in that regard. That said, we accept that from time to time outage rates of this magnitude will occur when plant is genuinely being maintained to improve its availability and reliability. Regarding the specific provisions of clause 4.11.1(h), we are not aware of the IMO lacking sufficient power to prevent abuse of the Market Rules, and perceive that if the IMO required additional powers it would identify that fact and would initiate a Rule Change Proposal to remedy the defect. We have confidence that as the IMO has not done so, no intervention is needed.

That said, we have no objection to additional powers being provided to the IMO in this regard. However, we would also add that removal of capacity credits is a very momentous act and should not be undertaken lightly and without prior warning because of the financial distress it could cause the participant.

## Discussion Point 7

*Stakeholders are invited to comment on the provisions of clause 4.27 of the Market Rules and whether the incentives for plant availability could be improved.*

As described in the Discussion Paper, Market Rule 4.27 provides for the IMO to monitor and investigate the reliability of in-service certified capacity.

Community Electricity reiterates its response to Discussion Point 6: we support the principle that certified capacity should provide the service that it is being paid for, we are

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not aware of the IMO lacking sufficient power to prevent abuse of the Market Rules, and perceive that if the IMO required additional powers it would identify that fact and would initiate a Rule Change Proposal to remedy the defect. As the IMO has not done so, we have confidence that no intervention is needed.

Furthermore, Community notes that this issue is being addressed through the IMO's Reserve Capacity Mechanism Review, which is proposing changes to the "Capacity Refund Mechanism". In particular, the review has developed proposals that the magnitude of capacity refunds should be linked to the quantity of reserve margin and should be paid to available generators instead of market customers, as is presently the case. We understand that the IMO's Review is now progressing to consultation and implementation of its proposals in this regard, and we support this as the optimal venue for this issue. That said, we would support a proposal to limit a Facility's right to receive planned outages in excess of a defined level, subject to IMO discretion.

## Discussion Point 8

*Stakeholders are invited to comment on whether the current market design provides appropriate incentives for retirement of inefficient generating units.*

Community Electricity reiterates its response to Discussion Point 7 that this issue is being addressed through the IMO's Reserve Capacity Mechanism Review, which is developing proposals to 'recycle' capacity refunds to available generators. We support this as the optimal venue for this issue.

More generally, without diminishing our support of the principle that capacity providers should provide the service for which they are being paid, we perceive that the relative worth of an unreliable coal-fired mid merit plant versus a reliable diesel-fired peaking unit that never runs because it bids at the price cap, is a subjective judgement. Such a judgement needs to be made from the perspective of complete information and with regard to the operational circumstances at the time. In particular, if the coal plant can be returned to service quickly in response to a contingency, then it is a valuable part of the generation mix from the perspective of fuel diversity. On the other hand, if its owner is lackadaisical in conducting a planned outage and takes much longer than reasonably needed, then a remedy is required.

Further to our comment in Discussion Point 7, we would support a discretionary limit on the level of Planned Outages that a Facility may take.

## Discussion Point 9

*Stakeholders are invited to comment on issues that are impacting on the efficient operation of the new LFAS market.*

Community supports the principle that the Wholesale Electricity Market needs an efficient and effective Load Following Ancillary Services (LFAS) market. We note that prior to the LFAS market commencement on 1 July 2012, Verve Energy was the monopoly provider according to administered prices. At this time, the total charge for the suite of Ancillary Services (including Spinning Reserve, Load Rejection Reserve, etc)

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was in the region of 1% of the cost of supply. We understand that since LFAS market commencement, Verve remains the only participant despite removal of the administered prices, and the aggregated Ancillary Services charges have approximately doubled. While the extent of the increases is expected to be mitigated through the commissioning of the Verve High Efficiency Gas Turbines committed to the provision of load following, the market cannot be considered efficient until private providers have proper participation in it. We understand that the principal barrier to private entry has been installation of the necessary generator automation together with the administration of the supporting contracts, and that these issues have been remedied. Insofar as any issues may remain unresolved, we consider the IMO's planned Market Evolution format, which will be focussing on improvements to the recently introduced Balancing Market, to be the optimal forum for this issue, conditional on the entry barriers being eliminated urgently.

In addition to the inefficiency of the LFAS market, we further note that the IMO is reviewing the allocation of LFAS charges to market participants, with particular emphasis on the quantity of LFAS required and its relation to the Technical Rules in general and System Management's Technical Envelope in particular. The interplay of the LFAS and Balancing Markets will also be a key feature of this. We understand that the IMO is considering bringing forward the Ancillary Services Review planned for 2014 and we support this as the optimal approach to resolve the issues.

## Discussion Point 10

*Stakeholders are invited to comment on whether the current information regime under the Market Rules presents a potential barrier to entry and what, if any, improvements can be made in promoting more efficient market outcomes.*

## General

Community Electricity welcomes the recent development of the LFAS and Balancing Markets and the provision of additional and better quality information in a more timely fashion. We particularly note that the provision of this information is enabling participants to challenge traditional System Management practices for the greater good of the market.

Community perceives that cost-reflective prices and the carbon price have increased consumer motivation to respond to price signals from the market, with particular emphasis on time-shifting of consumption and avoidance of capacity charges. It is therefore important that the relevant market information, such as Balancing Price and System Load, be disseminated publicly as well as amongst participants. Community also supports the transparent dissemination of outage information to enable more efficient planning and pricing.

## Notional Wholesale Meter

Community notes that approximately one third of the electricity market remains the exclusive franchise of the State-owned Electricity Retail Corporation (ERC) and that ERC receives a substantial subsidy for the losses it incurs as a result of regulated tariffs that are below cost reflectivity. We further note that the vast majority of the franchise

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load is represented by the Notional Wholesale Meter. We propose that the 30-minute consumption of the NWM should be published so that private retailers can assess the viability of supplying it and properly participate in a proper discussion of the relative merits of Full Retail Contestability. This information would also assist in the development of more effective pricing signals in conjunction with smart meters, and technology suppliers in developing and market their behind-the-meter products. It could even lead to the option of making contestable a proportion of the Notional Wholesale Meter as a means of mitigating ERC's 'losses'.

## Retirement of Kwinana C

Verve Energy's Kwinana C 365MW plant is understood to be scheduled for retirement in 2016-17. This has the potential to increase the Capacity Price by at least \$10,000/MW per year and would reduce the power system's coal-firing capability. It would assist the Market if the status of this retirement was formally confirmed in a timely manner, rather than being indirectly published via its inclusion or omission from the annual list of Capacity Certifications at the end of the capacity cycle.

## Discussion Point 11

*Stakeholders are invited to comment on how effective the IMO, System Management and the Authority have been in carrying out their respective functions in the WEM.*

## IMO

Community considers that the IMO has performed outstandingly well, with the design and implementation of the Balancing Market being the headline achievement. The initial indications are that Balancing Prices during the peak period have reduced by an amount that approximately offsets the newly introduced carbon price. Equally, the overnight price is frequently negative, thereby generating a price signal for the optimal mix of generating plant required. The IMO has also made good progress in reforming the Reserve Capacity Mechanism with particular emphasis on making the Capacity Price more responsive to market conditions, harmonising Demand Side Management with Schedule Generation and changing the Capacity Refund Mechanism to incentivise good performance and penalise poor performance according to system conditions. The IMO also completed the 5 year reviews of the Reliability Criteria and the Long Term Forecast.

## IMO-Governance

Community notes the Authority's comments in respect of the IMO governance issue. We are not aware of any substantive complaint in this regard and suggest that it should be remembered that the IMO does not have a commercial position to promote, and necessarily has to reconcile vested interests that are often in 'zero-sum' competition with each other. In addition, the Market Objectives themselves contain conflicts, such as the balance to be obtained between reliability and minimising cost. The objective to avoid discrimination also necessitates a judgement of the point at which failure to discriminate positively itself constitutes discrimination. In practice, the majority of the IMO's decisions are subject to detailed and transparent public consultation and it has been Community's experience that all participants have fair access to and participation on the supporting committees and their deliberations. It is also clear that the IMO Board

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actively engages with the evolution process and there are many instances of the board challenging the executive's recommendation on the basis of stakeholder submissions.

We would also note that the nature of the electricity market, and especially its subjective objectives and strict prudential requirements, require that the market be administered by a culture that ensures that the market is served by the regulations, rather than the regulations being served by the market. The IMO has a sound track record in this regard, including a recent self-nominated "breach" of the Market Rules to prevent a manifest error causing erroneous and material wealth transfers between participants. Community emphasises its support of such transparent and orderly "breaches", and would object to any move to eliminate or restrict them.

It is also especially important that Government Policy should not be reinterpreted as "market failure", as discussed in response to Discussion Point 2. While it is proper for Government to design and implement policies, we consider that any changes to the market governance should avoid a situation in which the Wholesale Market becomes an extension of the State-owned trading enterprises; the IMO must remain independent and the industry must not return to the intrinsically conflicted ethos that originally spawned development of the wholesale market. In particular, it should be noted that as the State owns both the dominant retailer and the dominant generator, the State remains relatively unaffected by wealth transfers between retailers and generators, while private participants can be seriously impaired to the advantage of the State-owned entities.

Community notes the market 'rumblings' to the effect that governance arrangements should mirror the 'separation of powers doctrine' that would be expected to apply in respect of a public institution capable of exercising power arbitrarily. However, we doubt that this applies of itself to the IMO as there is already a sufficient degree of regulatory oversight and appeal of its decisions. In particular, the Rule Change process contains scope for Policy Intervention from the Office of Energy, many of the IMO's decisions are subject to approval by the ERA, and the ERA conducts an annual general review of the IMO and the market. Moreover, arms-length governance would come at a financial cost and could not be justified unless it was outweighed by material benefits. Insofar as governance complaints may be in reality merely the next line of progression for an aggrieved commercially driven participant, we doubt that a sufficient case can be made. We would therefore suggest that prior to this issue being given credence, the IMO's decisions (which largely manifest via the Rule Change Process) should first be assessed against the Market Objectives for evidence of bias. Given that such an assessment is a central aspect of all rule changes, this would be straightforward and, we suggest, would demonstrate that the IMO's decisions have reasonably and properly furthered the Market Objectives in all cases, and often within contexts that are complex and subjective.

## System Management

Community considers that System Management has performed very well in the design, implementation and management of the new Balancing and LFAS Markets. In particular, we congratulate it on the major cultural change that has been instituted along with the establishment of a highly performing team of professionals. Noting its Western Power parentage, System Management's accessibility, consultation and innovation have been of a very high and innovative standard. While we regret the apparent dysfunction of the

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LFAS market, we recognise that it has imposed a great burden on System Management, and we have confidence that System Management's revitalised approach will deliver the required improvement and remedy of imperfections as the new markets mature and traditional operating practices are challenged and honed.

## The Authority

Community consider that the Authority has performed extremely well, with its establishment of the Bond Yield approach being an outstanding innovative and courageous initiative that has substantially reduced the price of electricity through denial of Western Power's original AA3 proposal and budget. We further congratulate the Authority on:

- a its review of the efficiency of Synergy's tariffs and its rebuttal of the initiative to merge Synergy and Verve; and
- b Approval of Western Power's Mid West Energy Project, which will facilitate connection of new power station developments and that development of that regions substantial natural resources.

## Other matters

Community notes that submissions are also invited in respect of any other operational, strategic, policy or otherwise high-level issues that are considered to be impacting on the effectiveness of the Wholesale Electricity Market the Market Objectives. We comment as follows.

### Constrained network access

Community supports the evolution of the present unconstrained network access ethos towards a constrained model. We welcome, and have separately supported, Western Power's recent initiatives to facilitate constrained access to developments in its north-country region, involving curtailment and run-back obligations in circumstances where no other network users are affected. We encourage further deployment of such approaches, with the aim of maximising use of the network and facilitating commercial developments.

### Contestable Meter Data Agent

Community notes that Western Power is the monopoly Meter Data Agent for the Wholesale Market and is denying reasonable access to interval meter data by customers and their representatives. Such access is required in furtherance of Market Objective e) to manage the amount of electricity used and when it is used and Market Objective d) to minimise the cost of electricity (by responding to price signals). The situation has degenerated to the extent that customers are now installing otherwise redundant parallel meters alongside the revenue meter for the sole purpose of collecting consumption data. Given the existing participation of these 3<sup>rd</sup> party meter service providers, we propose that the Meter Data Agent function should be made contestable.

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We further note that the effectiveness of the Wholesale Market could be improved by the more timely provision to the IMO of meter data that is central to the determination of the Balancing Price and the first settlements runs. The IMO currently depends on SCADA data provided by System Management in determining the Balancing Price, which has to be finalised within 3 days and cannot be reviewed afterward. The IMO is experiencing problems caused by inconsistencies between the two sources of nominally the same data, and if System Management can deliver the data on time, then so should Western Power (its ring-fenced parent).

## The non-contestable L1 gazetted tariff

Community notes that the Electricity Retail Corporation (Synergy) is required to provide electricity to non-contestable customers (consuming less than 50MWh per year) on the L1 tariff, which is approximately 20% lower than the equivalent contestable L3 tariff. Synergy then receives a Community Service Obligation in respect of the losses incurred through providing the subsidised supply. However, we also note that the L1 tariff retains the traditional high-consumption tier, whereby customers consuming in excess of ~50MWh *per month* get a further rebate. We understand that the L1 and L3 tariffs in combination serve some 90,000 customers consuming 1,626,000,000 kWh generating revenue of around \$370 million per year. We therefore propose review of the extent to which contestable customers are being supplied under the subsidised and supposedly non-contestable L1 tariff.

## Contact

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