alintaenergy

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Dear Wana,

DETERMINATION OF ALLOWABLE REVENUE AND FORECAST CAPITAL EXPENDITURE FOR THE IMO AND SYSTEM MANAGEMENT, 2013/14 TO 2015/16 – ISSUES PAPER

Alinta Energy (Alinta) appreciates the opportunity to provide a submission to the Economic Regulation Authority (the Authority) on the proposed Allowable Revenue and forecast capital expenditure for the Independent Market Operator (IMO) and System Management over the next three year period.

Alinta notes that participants in the Western Australian energy markets are currently exposed to a number of increased costs associated with the functions of the IMO and System Management. Further market design developments planned to occur during the next 3 years are likely to further add to these costs (both directly and via increased market fees). A high level overview of these market changes includes the:

- Final stages of implementation of the Balancing and Load Following markets, including the introduction of B2B/AGC arrangements;
- Development and implementation Gas Information Services Project (GISP), including the Gas Bulletin Board (GBB) and Gas Statement of Opportunities (GSOO); and
- IMO's Market Evolution Programme which, amongst other things, includes:
    - Further refinements to the Balancing market;
    - Development of an Emissions Intensity Index;
    - Transition to half hour gate closure; and
    - Introduction of a Spinning Reserve Market.

While Alinta acknowledges that some of the upcoming developments will lead to overall improvements for the energy market, it is essential that unnecessary costs are eliminated from the WEM and GBB/GSOO. Only those costs which are outweighed by a significant benefit to the market should be incurred. In this respect, Alinta notes its previous recommendation that an overarching review of the WEM be undertaken to ensure an effective market design that does not result in unnecessary costs and provides appropriate investment signals. Alinta also notes its support for post-project implementation reviews to be conducted to ensure that the anticipated benefits have eventuated to industry following the commencement of initiatives such as the Balancing market and GBB/GSOO.

Alinta estimates that the proposed substantive increases to the Allowable Revenue over the next three years for the IMO and System Management will have the effect of increasing market fees (including the Authority's costs[1]) to approximately $0.918/MWh (in real terms) for 2015/16. This represents an increase of approximately 30% from 2012/13. Alinta as a Gas Shipper will also potentially be charged fees for the operation of the GBB/GSOO which will need to be passed through to end customers.

Given the other cost drivers currently impacting on participants and ultimately end use customers in Western Australia, Alinta supports the Authority in undertaking a detailed review of whether the proposed levels of Allowable Revenue and forecast capital expenditure for both the IMO and System Management are appropriate.

System Management- Proposed Allowable Revenue

Alinta notes that following discussions with System Management it understands that much of the proposed increase in operating expenditure is to enable improved IT operations, including necessary increases in staffing to provide ongoing IT support. Decisions at market start were originally made to maintain existing Western Power IT systems however subsequent market design changes have meant these systems are no longer adequate. Alinta anticipates that improvements in System Management's operating systems will ultimately lead to a more reactive approach to system operations in the WEM which is anticipated to deliver efficiency benefits to the market in the medium/long-term. Alinta supports System Management in continually assessing whether these anticipated benefits are realised.

While Alinta is supportive of System Management's more detailed approach to determining its required Allowable Revenue and ensuring that costs are appropriately apportioned between System Management and Western Power, Alinta does not consider it is appropriate for the system operator to receive a return on capital as this may result in a conflict of interest when it comes to advising on the benefits of capital expenditures. Alinta is unaware of any other system/market operators that receive an allowance for returns on investment in Australia, including the IMO. However if the Authority considers System Management should receive a return on capital, Alinta does not consider it appropriate to apply a Weighted Average Cost of Capital (WACC) of 6.6% given:

- The Authority's application of a WACC of 3.6% in the Western Power's most recent Access Arrangement; and

- The IMO's application of a WACC of 5.95% for determining the Maximum Reserve Capacity Price for the 2015/16 Capacity Year. This is particularly relevant given the greater risks associated with investment in generation assets in the WEM as opposed to those capital assets used to operate the power system.

IMO – Proposed Allowable Revenue

Alinta acknowledges that the IMO's business has changed considerably in the past few years with the introduction of the Balancing and Load Following markets and forthcoming commencement of the Gas Information Services (GIS). The IMO's Allowable Revenue submission notes that it has made an allowance for the resources to operate the GIS, but indicates that this does not impact on this Allowable Revenue submission. Rather a separate Allowable Revenue approval will be sought from the Authority for the GIS. To ensure there is no potential double counting of costs associated with the

[1] Assumed for modelling purposes to be approximately 2.5% increases on current levels in 2013/14 and 2014/15 and 5.5% in 2015/16.

GIS resources; Alinta supports the Authority in further considering this matter when approving the Allowable Revenue for the GIS in upcoming months.

The IMO also notes that its submission reflects the operating costs associated with business as usual. As a result the progression of any further significant changes, including those anticipated under the Market Evolution Programme (MEP) such as the introduction of a Spinning Reserve market, have not been incorporated. The IMO indicates that should such reforms occur they would most likely be highlighted as a special project and funded accordingly. Alternatively System Management has directly incorporated into its Allowable Revenue a request for capital expenditure related to significant future market development initiatives such as the introduction of a Spinning Reserve market via the MEP.

Alinta supports the IMO in its approach to the treatment of these wider market initiatives. Market development initiatives need to be subject to wider cost/benefit assessments of alternative designs along with significant public consultation prior to funding approval being sought by the ERA. Alinta subsequently recommends that the Authority ensures a similar approach to only considering business as usual for the purposes of determining System Management's Allowable Revenue between 2013/14 and 2015/16.

Yours sincerely

Fiona Edmonds
Wholesale Regulation Manager,