



14 October 2013

Economic Regulation Authority
Level 4, Albert Facey House,
469 Wellington Street, Perth WA 6000

Discussion Paper: 2013 Wholesale Electricity Market Report to the Minister for Energy

Alinta Energy (**Alinta**) welcomes the opportunity to comment on the Authority's Discussion Paper regarding its 2013 Wholesale Electricity Market (**WEM**) Report to the Minister for Energy.

Alinta notes that since the Authority completed its 2012 WEM report two significant events have occurred. Firstly the WA Government announced its intention to remerge Verve Energy and Synergy on 1 January 2014; and the Minister for Energy announced a review of the WEM to be undertaken during 2014. Given the significance of these matters, Alinta is of the view the Authority's WEM report to the Minister for Energy should seek to complement the work to be undertaken by Government on these matters to ensure the on-going efficiency of the WEM.

In this regard Alinta outlines in this submission the most significant issues which it considers may hold back the further efficient development of the market. These issues should be addressed in the Authority's report to the Minister and through the further work to be undertaken by Government in relation to the above matters.

Market Governance

Alinta remains concerned the current market governance framework has the potential for conflicts of interest to arise. This is due to the Independent Market Operator (**IMO**) being responsible for determining whether or not to amend the Market Rules, for operating the WEM, and for enforcing the Market Rules.

The most effective markets have a strong governance framework that separates the three functions to remove any potential conflict of interest and create an environment where there is full and transparent discussion of issues. Alinta believes it is timely and appropriate to reconsider the current market governance arrangements, as was recommended by the Authority in its 2011 report to the Minister on the effectiveness of the WEM.

In addition, any review should consider the net benefit of streamlining functions and creating greater efficiencies. For example, System Management and the IMO appear to have similar market systems and there may be benefit in combining some or all of their functions.

Efficient dispatch of plant

Verve Energy currently controls a significant amount of the generation capacity in the WEM however it is the only generator allowed to bid its facilities as a portfolio. Alinta is concerned that the Verve portfolio can bid significant amounts of energy at a single price. This is most likely restricting competition in the Balancing market. Alinta is also concerned that by allowing Verve to treat its plant as a portfolio there is inefficient dispatch of plant. This may lead to poor operating decisions in the short term and poor investment decisions in the long term.

Alinta considers that these issues relating to the efficient dispatch of Verve plant should be addressed as a priority by putting in place a plan to transition Verve to bidding its facilities separately.

Appropriate investment signals

The benefit of the WEM's capacity market is that it incentivises the necessary investments to ensure security of supply during peak demand events. However, Alinta considers enhancements could be made to the current capacity market design to ensure that signals are sent to participants to invest in the type of capacity which benefits the market the most.

Value of generation capacity

The current market design does not incentivise the most reliable capacity given there is no differentiation between types of generation facilities.

In considering reliability, it should be noted that dual fuel capacity provides the highest level of reliability given it has the ability to generate even when the major fuel source for generators is curtailed. That is, while dual fuel facilities are generally run using natural gas, they can also run using diesel when gas is in short supply.

This significant benefit to the market was recognised by the committee established following the Varanus Island Gas Disruption in 2008 which recommended that incentives be put in place for investment in dual fuel facilities. This recommendation has not been implemented to date.

Given the acknowledged greater value of dual fuel facilities, particularly during a gas supply disruption, a mechanism to incentivise their development and reward their greater value should be implemented as part of any changes to the capacity market design. Likewise those facilities with additional storage capability are likely to provide additional value to the market from a capacity perspective. Whether this attribute should also be incentivised further and more appropriately rewarded is also worthy of further consideration.

Demand Side Management

The current market design treats Demand Side Management (**DSM**) the same as generation plant and therefore fails to consider the significant differences in the cost structures and risks faced by DSM providers, and DSM's contribution to long term security of supply. Alinta does not agree that DSM and all generation plant are in fact equal. Alinta considers that the differences in the relative value of DSM capacity and its underlying cost structures should be reflected in the amount paid for DSM capacity.

The upfront cost for DSM providers to enter the market is minimal and the risks faced are negligible. That is most DSM providers make a very small investment to be able to participate in the market but in return receive significant capacity payments. In addition, the risk of participation is limited because the investment is minor and the participant can exit at any time or choose not to participate by paying capacity refunds.

In addition, DSM does not contribute to long term security of supply. This is because DSM availability will change over time as DSM providers weigh up the net benefits of participating in the market. Their decision will be driven by the capacity payments they will receive compared to the costs of being available to provide the DSM service including the relevant Associated Loads opportunity costs which in many cases are likely to be significant. This net benefit assessment will be heavily impacted by the likelihood of DSM being dispatched in the market.

Given there is currently an excess supply in the market, DSM participation is a very attractive option for participants as the likelihood of being called is low, and there is significant net benefit from receiving capacity payments. However, as supply / demand tightens over time the attractiveness of providing DSM will diminish and DSM providers may start to exit the market. Therefore the capacity payments made to DSM providers results in limited long term benefit for the market.

This situation differs considerably for participants who invest a significant sum in generation plant in order to participate in the market. Given the cost of investing in plant is largely sunk, the plant will be made available to the market for the duration of the life of the plant and therefore the capacity payments made to the participant will continue to contribute to security of supply in the long term.

Alinta considers these fundamental issues warrants further consideration of DSM with a view to ultimately ensuring unnecessary costs are not incurred by the market and that DSM is appropriately compensated commensurate with its benefits to the system and underlying cost structures.

Alinta notes the proposed changes to the treatment of DSM developed during the Reserve Capacity Mechanism Working Group deliberations will not overcome the issues raised above. DSM will continue to benefit from positive discrimination compared to traditional generation given it will continue to receive the same capacity payments as a generator, while also benefiting from:

- not being liable for market fees;

- having reduced availability requirements when compared to generation;
- not being in the Balancing Merit Order (BMO); and
- not having its performance appropriately measured.

Accordingly, Alinta considers that any changes to the capacity market design should ensure that appropriate incentives for investment in DSM are being provided by better accounting for the significant differences between the relative costs and value of DSM compared to traditional generation facilities.

Balancing and Load Following Ancillary Services Markets

Alinta notes the Authority's Discussion Paper focuses on the Balancing and Load Following Ancillary Services Markets. These markets were established in 2012 and are therefore still in their infancy.

Alinta believes that it is too early for any clear conclusions to be drawn about the net benefits to the industry of these markets; Alinta however notes that those comments provided in its submission as part of the Authority's 2012 WEM review continue to remain relevant. Alinta wishes to make no further specific comments on the Balancing and Load Following markets at this time.

If you would like to discuss this submission please don't hesitate to contact me on 9486 3009.

Yours sincerely

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