



Economic Regulation Authority

Our Ref: D135218
Contact: Elizabeth Walters

Allan Dawson
Chief Executive Officer
Independent Market Operator
PO Box 7096 Cloister Square
Perth WA 6850

Dear Allan

RC_2014_05 Reduced Frequency of the Review of the Energy Price Limits (EPLs) and the Maximum Reserve Capacity Price (MRCP)

I am writing in relation to the IMO's recent proposed Rule Change to reduce the frequency of the review of the EPLs and MRCP.

Given the potential changes which may arise as a result of the Electricity Market Review currently being undertaken by the Government, the ERA considers any modifications to the current market power mitigation measures should be deferred until it is clear what the future industry structure and market design will be.

Notwithstanding the above, we note the frequency of these reviews is a matter which has previously been considered by the ERA, and believe it is relevant to revisit that work.

As you are aware, the ERA conducted a review of the methodology for setting the EPLs and MRCP. The ERA's report was provided to the Minister for Energy in September 2013 and published on the ERA's website in January 2014.

As set out in the report, the ERA recommended that the MRCP and EPLs be retained, as it considered the level of market concentration in the WEM remained relatively high, exposing the Wholesale Electricity Market to the potential misuse of market power, with consequential inefficient market outcomes and detrimental effects to consumers.

The ERA made a number of findings and recommendations it considered would improve the arrangements for determining the MRCP and EPLs including:

- In relation to the MRCP, the ERA considered the primary purpose for it is as a price cap for market power mitigation. The ERA recommended that this principle should be clearly stated in the Market Rules and that the linkage between the MRCP and the Reserve Capacity Price (**RCP**), as it currently stands, should be broken. The ERA considered an alternative method should be explored for setting the RCP when no market price for capacity is available. The ERA also recommended that the IMO should review the appropriateness of the methodology and estimating methods for determining the MRCP as part of its next five yearly review of the MRCP Market Procedure, which is due in 2015.
- In relation to the EPLs, the Market Rules should be amended to require the IMO to develop a Market Procedure that transparently describes the methodology to be used and the process to be followed for the EPLs review. As part of the Market Procedure development, consideration should be given to: whether a thorough EPLs

review should be conducted every three years, with appropriate escalators being applied to the components making up the EPLs between reviews; and the ability for the IMO to conduct a thorough review, at any time, should there be any significant changes in the market.

- The ERA recommended that, as part of the five yearly review of the MRCP Procedure and the development of a Market Procedure for the EPLs, consideration should be given to undertaking a thorough review every three years, with an appropriate escalator being applied between reviews and the ability for the IMO to conduct a thorough review, at any time, should there be any significant changes in the market.
- The ERA noted that there appeared to be some confusion regarding the roles of the ERA and IMO in relation to the review of the MRCP. The Market Rules require the ERA to undertake a review of the methodology for setting the MRCP every five years, with a separate requirement for the IMO to review the MRCP Market Procedure outlining the methodology and processes for calculating the MRCP at least every five years. The Authority recommended that the relevant clauses in the Market Rules be reviewed and modified to clearly identify the nature and scope of the reviews that are required of the ERA and the IMO, respectively.

In January 2014, the Minister advised the ERA that he considered the report met the ministerial reporting requirements under clause 2.26.4 of the *Wholesale Electricity Market Rules* and noted the ERA's assessment that the price limits considered in the Report provide protection from potential misuse of market power and continue to be needed.

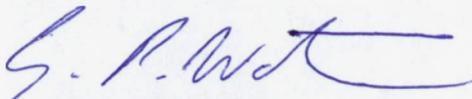
The Minister noted that the report proposed several improvements to arrangements for setting and review of these parameters for further development by the IMO, through a Rule Change or other processes under its control. He considered that these consultative processes provided a suitable forum for further consideration of the recommendations.

The ERA notes that the Rule Change proposed by the IMO takes into account some of the ERA's recommendations, in particular, reducing the frequency of reviews. Given the potential changes to industry structure and market design which may arise as a result of the Electricity Market Review, the requirement for market power mitigation measures is also likely to change. Once these changes are known, the design of any market power mitigation measure, including frequency of review, can be more properly made.

With that in mind, the ERA does not consider it appropriate for this Rule Change Proposal to be progressed at this time.

The ERA would be happy to discuss this matter further with the IMO.

Yours sincerely



GREG WATKINSON
CHIEF EXECUTIVE OFFICER

18/2/2015