
Wholesale Electricity Market Rule Change Proposal Submission Form

RC_2014_05 Reduced Frequency of the Review of the Energy Price Limits and the Maximum Reserve Capacity Price

Submitted by

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Submission

Background

The Wholesale Electricity Market Rules currently require the Independent Market Operator (**IMO**) to undertake annual reviews of two key market parameters; the Energy Price Limits (**EPL**) and the Maximum Reserve Capacity Price (**MRCP**).

During its recent five-yearly review of the methodology for setting these variables the Economic Regulation Authority (**ERA**) recommended that “*reducing the frequency of the EPL review and streamlining the review process will serve to promote greater efficiency in the market*”¹. The stated rationale for this is that the EPL variables do not vary significantly on an annual basis. The IMO also identified that the MRCP variables do not vary significantly on an annual basis and so proposed to reduce the frequency of both the EPL and MRCP review.

When the IMO’s initial proposal to reduce the frequency of both the EPL and MRCP review was provided to the Market Advisory Committee (**MAC**), Alinta had concerns that the appropriate balance between providing certainty and ensuring that the pricing parameters were reflective of conditions had not been achieved. Subsequently, Alinta worked directly with Synergy prior to the August 2014 MAC meeting to outline a number of recommendations to improve the overall intra-period review processes and associated governance, including establishing a number of potential criteria for triggering an intra-period review.

¹ ERA report, “Review of methodology for setting the Maximum Reserve Capacity Price and the Energy Price Limits in the Wholesale Electricity Market” (2014), recommendation 152, page 34.

Proposed changes in Rule Change Proposal

The IMO proposes to:

- Amend the Market Rules to move to a five-yearly review of the EPL and MRCP and to index the EPL monthly and quarterly, as applicable, and the MRCP annually between reviews (*Issue 2 and 5*); and
- Enable an intra-period review of the pricing parameters (i.e. the EPL and MRCP) under certain circumstances to mitigate the risk that the prices become un-responsive of the input parameters for any reason (*Issue 3*).

A number of additional changes are also proposed by the IMO including:

- Changes to the description of the prices in the Market Rules (*Issue 1*);
- The removal of the Market Procedure for determining the MRCP and the introduction of a requirement to instead provide relevant details of the proposed methodology to the ERA in any recommendation document for approval (*Issue 5*);
- Clarifying how the EPL are calculated in the Market Rules (*Issue 6*); and
- Removal of the specific ability for the IMO to undertake further consultation (*Issue 7*).

Alinta's views

While Alinta is generally supportive of providing greater price stability, which will be established by the adoption of five-yearly reviews of both the MRCP and EPL, we do not support the progression of the IMO's proposed changes as they:

- Should be postponed and considered as part of the wider Electricity Market Review (**EMR**), particularly given the uncertainty regarding the potential future design of the Wholesale Electricity Market (**WEM**);
- Will not establish an appropriate regulatory framework for setting and reviewing the pricing parameters in the market and therefore are unlikely to promote the Wholesale Market Objectives; and
- Do not strike an appropriate balance between:
 - Both providing greater certainty as to the pricing parameters for the market and reducing the associated cost of reviewing these parameters annually; and
 - Ensuring that the pricing parameters can be updated by enabling an intra-period review to occur where there is a significant and sustained change in the input parameters².

The proposed changes do not fully implement the key aspects of the recommendations that Alinta and Synergy previously put forward at the August 2014 MAC meeting to ensure an

² The other components of the proposal simply give effect to the broader move towards less frequent review of the price caps, including through implementing appropriate indexation requirements, and seek to improve the integrity of the Market Rules.

appropriate regulatory framework was established. While details of the proposed criteria that would need to be satisfied for an intra-period review to occur have in a limited sense been incorporated into the Amending Rules, the other important aspect of the proposal has not been included, i.e. that intra-review decisions be subject to a merits review. As a consequence Alinta's core concern remains that the proposed changes will not establish an intra-period review process that has sufficient regulatory oversight. This is explored further below, along with the rationale for establishing intra-period review decisions as being potentially subject to a merits review and Alinta's broader concerns with the proposed changes.

Ensuring sufficient regulatory oversight of the intra-period review process

Alinta considers that a regulatory regime is unlikely to be properly effective unless it can instil credibility, legitimacy and transparency with respect to decision-making. If a regulatory framework does not promote these objectives, it's unlikely to promote effective decision-making.

The proposed Amending Rules would not provide any process details for the making of a decision to undertake an intra-period review but rather simply provide the IMO with discretion around this matter. This is inconsistent with the objectives outlined above and it is unclear that effective decision making will eventuate if the proposed amendments are adopted in their current form.

Alinta assumes that an intra-period review can be requested (as it is not explicitly prohibited in the Amending Rules and the IMO's Rule Change Proposal contemplates this occurring) however the proposed regulatory framework does not actually require the IMO to make any decision. As such, Alinta understands that the proposed process of preparing a report outlining the outcomes of the IMO's assessment and undertaking consultation (clauses 4.16.10 - 4.16.13 and 6.20.7 -6.20.9) would only apply where the IMO has exercised its discretion to review the relevant pricing parameter.

Further, the proposed process does not provide for the necessary regulatory oversight of all aspects of decision making relating to the determination of the market's pricing parameters which could have significant, adverse effects on the financial and commercial interests of participants (see further below). This is because while the initial setting of the pricing parameters each five years will be subject to regulatory oversight through the ERA's approval process, the proposed regulatory framework would not provide:

- Transparency of significant aspects of the intra-period review process; or
- Oversight of any IMO determinations to undertake an intra-period review by another party.

Whilst Alinta is generally supportive of the IMO's approach of seeking to achieve greater efficiencies, as noted above, efficiency does not of itself constitute sufficient justification for change and must be considered alongside the other equally important criterion of effective decision making in order to ensure the broader Wholesale Market Objectives can be achieved.

As a consequence we do not consider that a proper balance between improved market efficiency and regulatory oversight has not been struck in the IMO's proposal. This can however be achieved through establishing the following³:

- Incorporating details of the process for undertaking an intra-period review into the proposed Amending Rules including:
 - Enabling participants to request an intra-period review of the pricing parameters where they consider the criteria specified in clauses 4.16.10 and 6.20.7 has been met; and
 - Requiring the IMO to make a decision to undertake an intra-period review (or not) when a request has been made and provide detailed reasons where it determines to not undertake an intra-period review⁴; and
- Making decisions by the IMO to undertake an intra-period review subject to a potential merits review by the Electricity Review Board (**ERB**) - this is explored further in the section below.

Establishing intra-period review decisions as subject to a potential merits review

Alinta considers that any decisions by the IMO to undertake an intra-period review (or not) should be made subject to a potential merits review by the ERB⁵ given the significant discretion afforded to the IMO and potential financial and commercial implications of decisions to participants.

The IMO has however recommended that intra-period review decisions should not be made subject to a merits review and provided a number of reasons in its Rule Change Proposal. Alinta does not agree with the IMO's assessment and notes that as both the rule maker and market operator, in this circumstance the IMO has a clear conflict of interest. While there are broader issues with the current governance arrangements that Alinta understands will be addressed by the EMR, we anticipate that any solution will ensure that appropriate formal processes are established⁶ to remove similar conflicts of interest around determining whether decisions should be subject to merits or procedural review. However, if the IMO determines to continue to progress the changes at this time, to ensure appropriate oversight is provided, Alinta supports the Public Utilities Office (**PUO**) in considering this matter separately and providing its independent advice as part of the Rule Change Process.

Specific details of Alinta's concerns with the IMO's proposal to not make this decision subject to a merits review are presented below⁷.

³ Alinta notes that more detailed process provisions could be provided in the relevant Market Procedure if required; thereby ensuring consistency with the IMO's principles based approach to drafting the Market Rules.

⁴ Alinta assumes that where a review is going to be undertaken that details of the rationale would be provided during the prescribed consultation processes.

⁵ Alinta considers that the ERB is the appropriate body to undertake these reviews as the nature of the assessment would be more akin to the determination and appeals functions relating to decisions by the IMO and ERA that already preside with the ERB. The alternative option may be for the ERA to provide oversight as this would be consistent with the governance provided for the broader processes for setting the pricing parameters for the WEM (this is however not Alinta's preference).

⁶ Alinta notes that currently there appears to only be an informal process for determining reviewable decisions whereby the IMO consults on any proposed reviewable decisions through its formal consultation processes for the relevant Rule Change Proposal and then (it is assumed) that the PUO takes the outcomes of this consultation into account when separately determining whether to update the relevant schedule in the WEM Regulations. To ensure both transparency and consistency, Alinta supports the development of a more formal process for establishing reviewable decisions.

⁷ Alinta notes that these concerns should be considered in the context of a specific requirement for the IMO to make a decision to undertake an intra-period review (or not) having been established in the proposed Amending Rules, as proposed above.

- ***Inconsistent with intention of the market design and the MAC's advice*** - The proposed Amending Rules (clause 4.16.10 and 6.20.6) would continue to afford significant discretion to the IMO as to whether to undertake an intra-period review (or not). This is because the IMO would need to come to a view that a change in the input parameters would have a “significant and sustained” impact on the relevant price cap. Alinta notes any decisions by the IMO with respect to undertaking (or not) an intra-period review would have significant potential financial and commercial implications for participants, particularly if another global financial crisis occurred.

The IMO's market design document states that where the IMO is afforded with discretion and there are significant potential financial and commercial implications of their decision, then the decision should be subject to review⁸. Similarly Alinta understands that the advice of the MAC at the August 2014 meeting was that intra-period review decisions should be subject to a potential merits review process.

Alinta also notes that determinations of prices and pricing parameters in other market contexts afford participants with an ability to seek an independent review. For example, applications can be made to the ERB by a person adversely affected by a relevant network decision of the ERA, including those relating to pricing and pricing parameters, under the *Electricity Industry Act 2004*. Similarly, for gas network access determinations by the ERA a separate limited merits review by the Australian Competition Tribunal is enabled by the *National Gas Access (WA) Act 2009*.

- ***Does not recognise that decisions makers will sometimes not make the right decision*** - Simply because participants would present evidence to the IMO in making an assessment as to whether an intra-period review should occur doesn't mean that the IMO (or any other decision maker) would necessarily always make the correct decision (contrary to the IMO's stated rationale for not recommending that intra-period review decision be subject to a merits review). Alinta considers that the market design should incorporate good governance processes that account for this and enable an option for independent reassessment of discretionary decisions that potentially have a significant impact on participants. This would align with good regulatory practice.
- ***Does not establish accountability for decisions by the IMO*** – Alinta considers that providing the IMO with discretion and then not enabling any appeal opportunity will potentially have implications for the quality of decision making. Making the IMO's decisions to undertake an intra-period review subject to a merits review process will hold the IMO more accountable for any errors or failures to take into account relevant information appropriately. This will address perceived broader governance concerns and ensure better decision making processes are put in place.
- ***Inappropriately assumes that participants would be unable to determine if a decision had a detrimental impact on them*** – Alinta is concerned with the IMO's assessment that it would be impossible for a participant to demonstrate that an intra-period review had a detrimental impact on them as part of the Rule Change Process.

The relevant provisions in the *Electricity Industry (Wholesale Electricity Market) Regulations (WEM Regulations)* provide that:

Currently as drafted it would not be possible to establish a reviewable decision as there is no explicit decision point, i.e. it would be possible for the IMO to simply not make any decision.

⁸ Wholesale Electricity Market Design Summary (24 October 2012), section 4.5.

- “A person whose interests are adversely affected by a reviewable decision may apply to the Board for a review of the decision”⁹;
- “If the Board decides that a person’s interests are not adversely affected by a reviewable decision, the Board must give the person written reasons for its decision”¹⁰; and
- “The [Board] may refuse to review a decision if it considers that the application for review is trivial or vexatious.”¹¹

Alinta considers that these provisions, properly interpreted, provide both an entitlement to participants to seek a merits review where they reasonably consider their interests have been adversely impacted by a reviewable decision as well as the appropriate safeguards to ensure that this entitlement is not abused. The key points are that:

- These provisions are designed to protect the interests of participants by providing a qualified appeals process in respect of a reviewable decision which adversely affects their interests.
- It is therefore up to participants (not the IMO) to determine in the first instance, on a case by case basis, whether they consider their interests to have been adversely affected and therefore whether to apply to the ERB for a review; and
- It is then up to the ERB (not the IMO) to determine:
 - Firstly whether the application for review should be granted (i.e. that it is neither frivolous or vexatious); and if so
 - Whether or not the case for review (i.e. that the participants interest have been adversely affected by a reviewable decision) has been made.

As such, any governance structure that attempts to restrict the ability of a participant to request the ERB to consider a decision where such a decision clearly meets the criteria for being subject to a merits review is inconsistent with both the words and intent of the WEM Regulations and should not, with respect, be supported.

While Alinta appreciates that the IMO may have provided this view to assist the PUO in its determination as to whether it would be appropriate to make any decisions subject to a potential merits review in the first place, Alinta further disagrees with the assessment that it would, in fact, be impossible to establish that a participant had been detrimentally impacted by a decision.

By way of example, the occurrence of a significant economic event, such as the global financial crisis, would have a demonstrable impact on a number of components of the MRCP. Market Participants have previously demonstrated an established capability to assess the likely implications of a change in the weighted average cost of capital (for example) on the MRCP and subsequently on their business depending on the

⁹ WEM Regulations, section 42(1).

¹⁰ WEM Regulations, section 42(3).

¹¹ Section 38(11) of Part 6 of Schedule 1 to the *Gas Pipeline Access (Western Australia) Act 1998* (now the Energy Arbitration and Review Act 1998 (WA)) as in effect at 31 December 2009 as incorporated by section 42(2) of the WEM Regulations.

commercial arrangements that are in place with respect to capacity provision. While it may not be possible to know the exact magnitude of any impact from a reassessment, Alinta considers that a participant would be well positioned to understand the potential implications to its business of a review and that it would in fact be imprudent for a participant to request an intra-period review if this was not the case.

Broader concerns

Alinta's broader concerns with the IMO's proposal follow:

- ***Uncertainty regarding how a "significant and sustained" event will be determined***
– While the IMO has adopted the main aspect of the recommendations made by Alinta and Synergy at the August 2014 MAC meeting, as currently proposed the criteria for intra-period review will still continue to create uncertainty as to when the MRCP and EPL will be reviewed. This is because it is unclear how the IMO will make an assessment that an event has had a "significant and sustained" impact on the MRCP and EPL's input parameters and whether a high or low threshold for review will be established.

To assist the market in better understanding how the IMO will potentially apply its discretion in assessing that an event has had a "significant and sustained" impact, Alinta recommends that further details of the criteria are outlined in the relevant Market Procedure, in line with the relevant examples presented at the August 2014 MAC meeting. In updating the relevant Market Procedure the IMO should seek to maximise regulatory certainty and obtain best decisions.

- ***It has not be established that the Producer Price Index (PPI) would be the most appropriate form of indexation*** – Alinta is concerned with the IMO's assessment that the PPI would be the most appropriate indexation for the EPL and MRCP. The IMO explicitly states that "historically the Maximum Energy Price and the Alternative Maximum Energy Price have a good correlation to the PPI". Details of this correlation do not however appear to have been provided to enable interested parties to make their own assessment of this matter. Additionally as a footnote the IMO notes it has been not able to undertake a "meaningful analysis" of the MRCP against the PPI. It is therefore unclear whether indexation against the PPI would be appropriate for the MRCP.

To enable interested parties to provide useful views on this matter to the IMO, Alinta considers that the details of the correlation between the EPL and the PPI should be made available to industry as part of the current Rule Change Process.

- ***The current proposal would not be consistent with the Wholesale Market Objectives*** - The regulatory framework for setting the pricing parameters in the market (in its entirety) needs to be subject to appropriate oversight in order to ensure that the Wholesale Market Objectives are not compromised. A framework that does not establish an appropriate regulatory process and could potentially allow significant changes (intra-period) to not be reflected in the pricing parameters would not be consistent with the Wholesale Market Objectives.

If you wish to discuss any of the points raised in this submission further please directly contact Fiona Wiseman, Wholesale Regulation Manager at Alinta Energy.