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4 September 2017

Dear Ms. O'Connor

RESPONSE TO DISCUSSION PAPER – 2016/17 WHOLESALE ELECTRICITY MARKET REPORT FOR THE MINISTER

Bluewaters welcomes the opportunity to provide comments on the paper entitled “Discussion Paper – 2016/17 Wholesale Electricity Market Report for the Minister” ([Discussion Paper](#)), published by the Economic Regulation Authority (Authority) in July 2017.

Energy policy uncertainty

Bluewaters notes that the recent change of Western Australian government (Government) gives rise to uncertainty in regards to the future of the Electricity Market Review (EMR) and the State’s energy policy in general. Bluewaters considers any delay in providing policy certainty to be detrimental to the Wholesale Electricity Market (WEM) in meeting the Wholesale Market Objectives. For example, Market Participants may find it difficult to secure finance until there is clarification in regards to the timing of, and the rules associated with, the capacity auction.¹

As such, Bluewaters recommends that the Minister for Energy (Minister) mitigates any such uncertainties by providing energy policy guidance in a timely manner to the maximum extent practicable.

Minister’s role in the reform process

Bluewaters considers a market reform process may require introduction of both step and incremental changes to the market design. Step changes involve fundamental policy decisions to strategically respond to the rapidly changing landscape of the energy industry, while incremental changes would involve a market evolution for optimising the performance of the market (in meeting the Wholesale Market Objectives) given the set policy framework.

Bluewaters is of the view that it is the Minister’s role (supported by the Public Utilities Office) to propose step changes to the market design by strategically setting the appropriate policy framework. Examples of such changes are: (a) reforms to the electricity market governance and institutional frameworks; (b) adoption of the constrained network access model; (c) integrating renewable energy into the SWIS; and (d) reform to the market structure (that is, restructuring Synergy to increase competition in the WEM). Bluewaters considers adequate public consultation needs to be held before introducing any of these changes..

Bluewaters considers any incremental changes should be introduced and managed through the electricity market governance and institutional frameworks. These frameworks, if properly designed by the Minister, would: (a) allow adequate public consultation to be part of the decision making process to enable better informed changes to take place; and (b) allow the market to evolve at its natural pace. An example of the market governance and institutional frameworks is the Rule Change Process administered by the Rule Change Panel, supported by the Market Advisory Committee (MAC).

¹ Discussed later in this submission. A capacity auction refers to the auction process for reserve capacity, as contemplated under the EMR. This is not to be confused with the Reserve Capacity Auction under clause 4.15.2 of the Market Rules (and related clauses).

Since the adoption of the EMR by the Minister for Energy under the previous government, there has been an effective hiatus on the normal operation of electricity market governance and institutional frameworks.

Since the institutional reform is now complete, it is important that the new Minister quickly hands back 'operational control' of the Market Rules to the institutions set up to administer them and allows the market to revert to business as usual. To facilitate this, the Minister should, as a matter of urgency, clearly identify the remaining reform packages to be pursued and set up appropriate administrative processes to do so. These processes must interact closely with existing institutions (e.g. the Rule Change Panel and the MAC) in order for those bodies to continue to allow the market to function as designed.

WEM market structure issue and market power mitigation

Bluewaters considers having an appropriate market structure² for delivering effective competition is a central issue and should be a threshold requirement in any market reform. Bluewaters also considers effectiveness of many other aspects of the EMR is likely to be compromised unless this threshold requirement is met.

Given Synergy's dominant position in the WEM, restructuring Synergy is a critical element for providing a market structure for promoting effective competition. Bluewaters recommends that the Minister takes this into account in reforming the Western Australia's electricity sector.

Bluewaters notes that restructuring or divesting Synergy's generation assets was an option not progressed in the previous government's EMR. Bluewaters agrees with the Authority that this is an opportune time to revisit this matter.

Encouraging competition is one of the Wholesale Market Objectives. Furthermore, effective competition is likely to promote the Wholesale Market Objective of minimising the "the long-term cost of electricity supplied to customers from the South West interconnected system [SWIS]".

WEM Fees³ reform

Bluewaters considers the costs to operate the WEM is very high. This is evidenced by the Authority's finding in its [first 2016-2019 AEMO Allowable Revenue Determination](#) that such cost in the WEM, on a per MWh load basis, is significantly higher than that for the National Electricity Market (NEM). Bluewaters recommends that measures be put in place to extract further efficiency from AEMO's market and system operation functions so that more reasonable WEM Fees can be achieved.

The market reform cost will further increase the already high WEM Fees levied on Market Participants. Under the current cost allocation arrangement, the costs associated with the market reform are recovered through the WEM Fee structure. That is, the costs are allocated between the generators and loads on a 50/50 basis⁴.

Bluewaters questions if this arrangement represents an efficient cost recovery mechanism. Bluewaters considers it is most efficient to recover the costs from an entity based on the benefit it receives from the reform. This is expected to increase the visibility of, and therefore incentivise, prudence and accountability when it comes to deciding the need and scope of the reform. This is not reflected in the current mechanism.

Bluewaters recommends that the Minister mandates a review on allocation of the WEM Fees.

Capacity auction

Bluewaters welcomes the Minister's announcement during the 17th Energy in WA Conference (Conference) that there will be no reserve capacity auction until 2021. However, uncertainty still remains as to whether an auction is still a preferred policy position, and if so, what the design of an auction might look like.

Bluewaters considers there is little value in having a capacity auction until there is effective competition in the WEM's reserve capacity market. It is unlikely that effectiveness in competition can be achieved without restructuring Synergy.

² Market structure can be defined as, the number of firms producing the identical goods and services in the market, and such structure is determined on the basis of the competition prevailing in that market.

³ WEM Fees include Market Fees, System Management Fees and Regulator Fees (as defined in the Market Rules).

⁴ Clause 9.13.1 of the Market Rules.

Given the lack of effective competition, any capacity auction would require market power mitigation measures to be incorporated into its design. This would essentially turn the auction price outcome into an administered price.

The transitional capacity pricing arrangement⁵ is already a functional administered pricing arrangement.⁶ Bluewaters sees little value in moving from one administered pricing arrangement to another (potentially more complex and less effective) administered pricing arrangement. As such, Bluewaters does not consider developing a capacity auction model to be a prudent use of the WEM's valuable resources at this stage.

Bluewaters considers the WEM resources should be allocated to improving the existing transitional arrangement to further enhance the price signal and potentially adopting it as a permanent arrangement. An auction model should be considered only if there is a clear policy commitment to introduce effective competition in the reserve capacity market.⁷

Constrained network access and security-constrained generator dispatch

Bluewaters considers a constrained network access model and security-constrained generator dispatch arrangement are likely to promote the Wholesale Market Objectives.

Bluewaters agrees that the security-constrained generator dispatch arrangement is likely to allow for the efficient, transparent and least-cost dispatch of generators while maintaining the security of the system. Bluewaters also notes that the constrained network access model would promote efficiency in future network investments. In addition, a constrained network access model and security-constrained generator dispatch arrangement would provide locational signal to facilitate adequate amount of capacity to be built in the appropriate location in such a way that minimises network congestion in the SWIS.

Introducing a constrained network access model and a security-constrained generator dispatch arrangement gives rise to question as to how the incumbent Market Participants' existing firm network access rights are to be dealt with. Bluewaters notes that this issue remains unresolved and urges action to resolve this matter, including consultation with the affected stakeholders, before progressing the reform.

Introducing a constrained network access model and a security-constrained generator dispatch arrangement may also have implications on the capacity credit allocation arrangement for Market Participants. It is understood that the EMR intended to design an arrangement to penalise capacity providers whose assets are in network locations that contributes to network congestion (by awarding less capacity credits to the provider compared to what it would otherwise receive). This has merit when applied to a new entrant with the ability to make locational decisions. But if applied to incumbent generation capacity, which cannot relocate to respond to the locational signal, the design would be ineffective in achieving its intended purpose.

In addition, this also represents wealth transfer and sovereign risk that could not have been reasonably anticipated by investors. This would undermine future investors' confidence in Western Australia as an investment destination. This would require a higher risk premium to attract capital for investing in the WEM, resulting in increased cost of electricity supply. This does not promote the Wholesale Market Objectives.

Managing increasing penetration of intermittent generators

Bluewaters considers renewable energy plays an important role in assisting Australia in its transition to a low carbon economy. However, due to the intermittent nature of the renewable energy generation, emergence of such energy source is expected to give rise to some economic and technical challenges⁸ in a power system. While the renewable energy generation technologies may evolve and mature over time to become the dominate source of energy in the future, Bluewaters considers the economic and technical challenges at present means it is not feasible to force adoption of the intermittent generators on a large scale basis.

Rather, Bluewaters considers intermittent generators should be carefully integrated into the SWIS in such a way that preserves the security, reliability and efficiency of the power system. Bluewaters also notes that integrating these intermittent generators is complex and requires the appropriate coordination in order to

⁵ That is, the Lantau Curve.

⁶ To commence operation on 1 October 2017.

⁷ Other conditions for introducing a capacity auction process as contemplated under the EMR should also apply. One of these conditions is removal of excess capacity in the WEM before commencing the operation the auction model.

⁸ For example, system inertia problem.

ensure a smooth transition. Bluewaters considers adequate public consultation will play an important role to ensure that an appropriate transition solution can be developed.

Bluewaters considers the conventional power generation technology (including coal and gas fired power generation) will play a major role in providing the transition solution. As such, there should be sufficient mechanism to ensure that these fossil fuelled plants in the WEM (especially those with high fuel efficiency and controlled emission) do not prematurely exit the market and placing a risk on power system reliability and security.

Bluewaters is of the view that the Minister can consider setting up a planning body for coordinating the integration of the intermittent generators in the WEM. This planning body may be modelled on the Finkel Review's Energy Security Board, but through a public consultation process, be modified to suit the circumstances in the WEM.

Cost recovery for the Behind the Meter (BTM) facilities

Bluewaters notes that significant proportion of intermittent generators (e.g. PV solar panel) are BTM facilities. Under the current market arrangement, the electricity generation from the BTM facilities are considered to be net-off to the load, rather than electricity generation itself. This means the BTM facilities do not contribute to their fair shares of: (a) the transmission and distribution networks costs and (b) the fees to support the market operations in the WEM. This is despite the fact that these BTM facilities require access to the networks and the service of the WEM due to the intermittent nature of these generation facilities.

Bluewaters considers this creates an inequitable situation where the BTM facilities get free access to the networks and market services at the expense of the non-BTM facilities. Bluewaters considers this to be an inefficient allocation of costs and can potentially distort the investment signal in the WEM.⁹ Bluewaters also notes that the rapid growth of the BTM facilities will only magnify this problem.

A solution to address such inefficiency is to treat the BTM generation as actual generation rather than a net-off to the electricity demand. An enabler of this arrangement is to invest in infrastructure to improve the visibility of the BTM generators and allocate costs to this generation accordingly.

Improving visibility of the BTM generation will also provide useful information to system operator for maintaining the security of the power system. Bluewaters considers this view to be consistent with Recommendation 2.6 of the [Finkel Review](#) which recommends development of "a data collection framework (or other mechanism) to provide static and real-time data for all forms of distributed energy resources at a suitable level of aggregation."

Facility bidding

Facility bidding within the Synergy portfolio will provide transparency and promote efficiency. This is expected to provide the appropriate signal for entry and exit of generation plants (including Synergy and non-Synergy plants) in the WEM.

It is also noted that facility bidding is a requirement in order to allow effective functioning of the security constrained dispatch model.

Co-optimised energy and ancillary services model

A co-optimised energy and ancillary services model is likely to promote competition in the energy and ancillary services market. Bluewaters is supportive of progressing with the design and implementation of this model.

Security constrained dispatch engine

Bluewaters supports the adoption of the security constrained dispatch engine in the WEM. This will enable further automation of the plant dispatch process in the WEM, and in turn improve efficiency and equitability of the dispatch process.

For the reason discussed above (and also similar to the 'causer pays' argument), it is most efficient (and also more equitable) to allocate the costs of implementing a specific reform to an entity based on the benefit it

⁹ That is, artificially over-encouraging investment in BTM facilities (due to the "free-ride") while neglecting the need to allocate capital to the non-BTM facilities investments.

receives from the reform. As it is the end customer which will be the major beneficiary of implementing this dispatch engine¹⁰, Bluewaters considers they should contribute to the majority of this cost¹¹.

Institutional arrangement

The institutional reform under the EMR implemented a separation of duties arrangement to address the potential conflicts of interest among the rule making, market operating and rules enforcement and compliance functions.¹²

Bluewaters notes that, under the reformed arrangement, the rule making function is undertaken by the Rule Change Panel while the rules enforcement and compliance function is undertaken by the Authority. The Authority's Secretariat provides the Secretariat service to the Rule Change Panel.

This means there is potentially a lack of separation of duties at the Secretariat level between the Rule Change Panel and the Authority. This may give rise to conflicts, or perceived conflicts, of interest between the two bodies at the Secretariat level.

On 16 August 2017, during a MAC meeting, the Authority's Secretariat advised that there are ring-fencing arrangement and internal governance processes which address such potential conflicts of interest.

Bluewaters considers these ring-fencing arrangement and internal governance to be critical for addressing the potential conflicts of interest and therefore is of the view that their effectiveness should be demonstrated periodically in a transparent manner. For example, the Authority may wish to subject the ring-fencing arrangement and internal governance to an annual audit to demonstrate their effectiveness, publish the result of such audit and invite comments on the result.

Bluewaters thanks the Authority for considering this submission. Should you have any questions regarding this submission please contact Ignatius Chin on 08 9261 2890 or ignatius.chin@bluewatersps.com.au.

Thank you.

Yours sincerely

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Chief Executive Officer

¹⁰ That is, minimising the long term cost of electricity supplied to customer. This is expected to result in lower electricity price for the end consumers.

¹¹ For example, introducing a market reform levy on the electricity customers rather than recovering the cost through the WEM Fees structure.

¹² These functions were previously undertaken by the Independent Market Operator (IMO). The lack separation of duties gave rise to potential conflicts of interest.