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

Submitted via the portal on the ERA's website

2016/17 Wholesale Electricity Market Report for the Minister

ERM Power Limited (ERM) welcomes the opportunity to provide comment and feedback into the Economic Regulation Authority's (ERA) 2016/17 Wholesale Electricity Market Report for the Minister. Given that the Minister for Energy has yet to make detailed announcements of its intentions regarding widespread reforms to the Wholesale Electricity Market (WEM), ERM agrees with the ERA's intention for this report to serve as a useful guide for the Minister in his deliberations.

The ERA has sought comment and feedback on areas for immediate focus and for comment on whether the Electricity Market Review reforms were sufficient or whether more needs to be done. ERM will provide its views in this submission.

About ERM Power

ERM Power Limited (ERM Power) is a listed Australian energy company (EPW) operating electricity sales, generation and energy solutions businesses. The company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load, with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services, including lighting and energy efficiency software and data analytics, are being delivered to the company's existing and new customer base. ERM Power also sells electricity in several markets in the United States. The company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. It is the only retailer in Australia to operate in every state.

Policy Uncertainty

The ERA has highlighted that Western Australia is not alone when it comes to a "heightened sense of uncertainty" in the electricity sector. This sense of uncertainty in the energy policy space is an impediment to the effectiveness of the market. It is imperative for the efficient and effective operation of the market that clarity and a road map for reform is developed for the WEM. Energy policy should be enduring with a longer term focus which does not change significantly with changes in government.

The Electricity Market Review was a wide ranging review which would have overseen major reforms to the Wholesale and Retail markets as well as significantly changing the Networks environment.

With the recent change of government, reforms associated with the Electricity Market Review have stalled and there has been uncertainty as to whether the reforms would be progressed. In order to provide an environment that is conducive to investment in Western Australia, and at the same time a good outcome for WA consumers, transparency and certainty in energy policy are prerequisites.

Competition in the WEM

It is ERM's opinion that in order for the WEM to be an efficient and effective competitive electricity market, the structure of the market needs to be urgently addressed. The size and structure of Synergy as the dominant generator-retailer is a key impediment to a fully competitive market and in order for progress to be made the first step is for the structure of Synergy to be addressed. This issue is not new and as has been noted by the ERA, was raised in Phase 1 of the Electricity Market Review process and is the major barrier to effective competition in the WEM.

In Phase 1 of the Electricity Market Review, it was recognised that the merged Synergy entity should be split into two or three generator-retailers to encourage more competition. This was a recommendation that Government did not adopt.

Moving forward, if Government decides to not address structural issues in this way, certainly a de-merger of the Wholesale and Retail businesses would be preferable over the current merged entity. This at least would lead to more transparency and structural separation between the businesses and for the market, as well as provide a better platform for competition.

Wholesale Market Reforms

The proposed package of wholesale market reforms that were being progressed under the Electricity Market Review should continue. However, the implementation of these reforms should be progressed in a consultative manner, not pursued as a result of having to meet a deadline, resulting in system requirements driving market rule changes rather than market rules reflecting changes that will provide benefits for consumers in the WEM.

The NEM and WEM are quite different markets and while the adoption of NEM systems has been proposed for the WEM, unilateral adoption of the NEM systems without appropriate detailed review and consultation is inappropriate and will result in a range of inefficiencies and issues.

The NEM is currently undergoing a period of significant change with a number of regulatory reviews being undertaken to address a number of concerns that have been well publicised.

It should not be assumed that the WEM will adopt those changes simply because the WEM may be adopting NEM systems. The WEM is well placed to monitor how these changes are put in to practice and how effective or otherwise they prove to be, and consider whether new policies and approaches are worth implementing here.

To date, taking a steady and different approach to many aspects of the electricity market here versus the NEM has benefited WEM consumers in terms of relative price stability and security of supply, if not price.

Capacity Market Reforms

The transitional arrangements for the Reserve Capacity Market mechanism are due to go live on 1 October 2017. The impacts of the changes are evident as there is less capacity certified with a significant proportion of demand side programmes electing to not be certified. However, there is still significant uncertainty surrounding the proposed reserve capacity auction mechanism that is to commence in 2021 for the 2023/24 Capacity Year if it is not triggered earlier. A recent announcement

made by the Minister indicates that the auction will not proceed until 2021. This is a good outcome for the market as there was significant uncertainty surrounding the auction process.

The proposed capacity auction mechanism is complex and does not provide any certainty for market generators. The few details that have been developed for the auction mechanism indicate that the auction mechanism could turn out to be another administrative price mechanism just like the Lantau Curve. If one is to move from one administrative price mechanism to another, ERM's view is that it would be best to just stay with the Lantau Curve transition mechanism.

The auction mechanism was not favoured by market participants in the first instance and was approved by the Electricity Market Review Steering Committee with no input from market participants. It was a concept that market participants were not in favour of but had limited opportunity to comment on. If the ERA was to consider recommending changes to Government to improve the effectiveness of the market, removing the auction mechanism should be one of those changes.

The Lantau curve itself is probably an appropriate pricing mechanism to be used over the transition period but should be reviewed to ensure that it is still appropriate for the market post 2021/22.

Retail Market Reforms

For effective competition to occur in the retail market, as discussed earlier, the size of Synergy has to be dealt with. Effective competition will not eventuate no matter the reforms which are undertaken if structurally the market is not designed for it.

However, if no structural reforms are undertaken and if one was to insist on reform in the retail space, the retail market should be separated into two segments, non-residential, which comprises all businesses, and residential. To ensure transparency and reduce confusion, the term Franchise should be removed and not used in the context of the electricity market.

Reform of the residential and non-residential segments need to be dealt with quite separately as they are markets with completely different issues. The non-residential sector can be made fully contestable relatively quickly with a transition period from tariffs to contestability over a short period, and the removal of business tariffs, in particular ones that are currently eligible for CSO payments as a result of falling into the category of Franchise customers. A good example of the quick transition from non-contestable to contestable was experienced in Tasmania where businesses were given 12 months' notice that they were to become contestable and were required to resolve their electricity supply needs before the contestability start date.

The residential segment can remain on tariffs until such time full retail contestability is introduced with full transparency of the cost basis of any community service obligation refund to Synergy. This should be audited annually and tabled in Parliament.

If full retail contestability is the goal, then it needs to be planned and implemented in a structured manner allowing sufficient time for consultation and implementation and not rushed. The community service obligation has to be fully understood and made transparent before full retail contestability is introduced.

At this point in time ERM does not see publicly the desire for full retail contestability. For the community to be brought along in the process of electricity reform, it is essential that they understand that the market structure will protect vulnerable members of the community.

It is clear the community is not going to support further reform unless the reform process affords them with a level of price stability and certainty of supply. They also would expect that all businesses, small and large, pay a fully cost reflective price. This could be quickly implemented.

The WEM has been operating for just over ten years and there has never been a review of the way that the Individual Reserve Capacity Requirement (IRCR) has been calculated and levied on customers. Since there are significant reforms potentially being undertaken, it might be timely to also consider whether the current IRCR mechanism can be improved. For example, the current mechanism does not facilitate customers taking reasonable proactive steps to reduce their demand at times of peak consumption in a sustainable fashion. Hence an opportunity is being lost to reduce the need for future capacity as customers are by and large ignoring their demand profiles.

This issue has a correlation to demand response but it is not demand response. It is about customers having more confidence in what days will be IRCR days and being able to do something about it unlike the current process, which is a look back process. Take for example, in Victoria, Distribution companies can, day ahead give notice for a “capacity day”, which in essence is notice that the next day is going to be a high demand day. This then allows customers the opportunity to try and reduce demand for that day. Similarly, this could be implemented in the WEM which could result in a sustainable reduction of the amount of capacity required in the WEM due to customers having a level of control to reduce their demand when they know of the potential for a “capacity day” being called. This is just an example of a potential improvement that could be introduced as part of the Retail Market Reform process.

Network Reforms

ERM understands and supports the need for the SWIS to adopt a constrained grid access environment. However, it is imperative in the transition to the constrained access environment that meaningful consultation with market participants is undertaken. In particular, concerns that existing generators may have with respect to their current firm access and how they may be impacted with the removal of that firm access have to be dealt with in a consultative manner. Consultation in the network reforms process to move to a constrained grid environment has been poor to date.

The Minister in June 2017 gazetted new rules to allow a new class of connection for generators seeking access to the grid. In this process, the Minister recognized the financial impact on these generators if they could not resolve access issues before the capacity certification process closed for the 2016 and 2017 Reserve Capacity Cycles. As a result, the deadlines for making reserve capacity applications for the 2016 and 2017 Reserve Capacity Cycles were delayed to allow these interim access generators an opportunity to resolve its issues with Western Power and to be able to make its applications for certified reserve capacity.

Similarly, existing generators should be afforded the same opportunity to have their contractual positions resolved with Western Power prior to legislation being introduced for the implementation of the constrained grid environment. This ensures that existing generators aren't unfairly treated during this transition period.

Other Matters

Although the reforms discussed above appear to be independent of each other, it is important to note that they aren't independent and that changes in one market can significantly affect another market. For example, it is important that network reforms that are undertaken preserve the economics of synchronous peaking generation in a market that will be transitioning to higher levels of intermittent generation. That is, the impact of the constrained grid access environment on the energy and ancillary services and capacity markets are considered in full during this process. The entry of more intermittent generation in the SWIS is likely to impact various parts of the SWIS and potentially constrain synchronous generation leading to instability in the network. These considerations and the

inter-linkages between markets have to be identified and the ramifications considered for existing and new generators.

Any reform process requires significant consultation to occur between the entities that conduct policy planning and participants in the market. While consultation did occur in the Electricity Market Review process, it was often insufficient and not inclusive. Changes in the WEM should be approached in a measured manner with appropriate and meaningful consultation to get the best outcome for the market, and ultimately consumers.

Please don't hesitate to contact me at wng@ermpower.com.au or on 08 6318 6416 if you would like to discuss any of ERM's views outlined in this submission.

Yours sincerely

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