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Kleenheat CONFIDENTIAL submission for:

#### "Report to the Minister for Energy on the Effectiveness of the Wholesale Electricity Market 2017/18. Discussion paper"

To whom it my concern.

Thank you for the opportunity to present our feedback to the review into the Effectiveness of the Wholesale Electricity Market.

Amongst its businesses, Kleenheat retails electricity, natural gas and electricity to ~250,000 consumers in WA, particularly in its south west region.

Kleenheat has a strong presence in the WA energy market, having retailed LPG to customers for over 60 years and natural gas to residential and commercial customers since 2013, when it introduced competition into a monopoly market. Kleenheat has also sold electricity to commercial customers since 2007.

Kleenheat currently has no wholesale electricity production/generation assets of its own. It operates as a pure retailer, and purchases its electricity needs through the wholesale electricity market ("WEM") or via bilateral agreements with Synergy. Kleenheat's experience in operating in the WEM is that it is generally difficult to access wholesale electricity on competitive terms.

We appreciate the opportunity to provide feedback to this process. As we do not operate any of our own generation, we have not provided feedback to all questions raised in the report but have limited our feedback to where we think our experience is most relevant.

Should you require any additional detail, or wish to discuss our submission further, please feel free to contact us.



Sarah York

General Manager Kleenheat Natural Gas and Electricity

*Question 3* Is the market applying sufficient pricing discipline on generators in light of the high level of concentration in the WEM?

Kleenheat operates an LPG and natural gas retail business and currently supplies over 250,000 customers within the State's south west region, typically the region covered by the SWIS. Given its customer base, Kleenheat continues to maintain a presence offering electricity to its gas customers when permitted but has found this increasingly unattractive in recent years.

As summarised above, Kleenheat relies on the WEM and Synergy to source its electricity needs. Electricity is sourced through a combination of back-to-back contracts with Synergy on an ad-hoc basis, fixed blocks of electricity offered as standard products, the STEM and balancing markets. The first two products offer an opportunity for Kleenheat to minimise its price risk exposure under its retailing activity, however Kleenheat's experience in sourcing electricity is that it is difficult to obtain it on a competitive commercial basis. Synergy's back to back and standard products are typically not a viable option for sourcing wholesale electricity, as evidenced by the lack of liquidity in them.

Accessing electricity through the current wholesale market is generally uncompetitive and, even with its low-cost base and small electricity team, Kleenheat's ability to profitably secure new customers is very low. In the absence of facility bidding for Synergy's generators, it is currently unclear whether there is sufficient pricing discipline on generators (85 per cent of which are owned or controlled by Synergy). This situation ultimately affects Kleenheat's ability to compete effectively in the retail electricity market.

Question 4 Aside from disaggregation, what other measures could improve competitive discipline in the WEM? How would these measures work?

In previous submissions Kleenheat has supported the idea of promoting a more liquid wholesale forward market through the use of a mandatory auction process for a quantity of electricity from Synergy, in lieu of the current standard products regime.

Alternatively, some other options are summarised below.

# Creating a level playing field

- Closing the bid-ask spread on Synergy standard products in order to improve liquidity of both buy and sell products and enforce more price discipline.
- Requiring additional maturities within the current Standard Product regime in order to allow non-gentailers to hedge longer dated retail offers.
- Transparency of, or assurance that, processes for and transfer pricing between Synergy WBU and RBU are similar to that available to competitors as specified under Part 3 of the EGRC regulations 2013 and Synergy's wholesale supply policy.

Part 3 Section 22 of the EGRC regulations requires that Synergy not offer wholesale electricity to Synergy's RBU *having regard to all relevant circumstances* on terms more favourable than that offered to retail competitors. The market currently has no visibility into actual transfer prices between WBU and RBU and whether "all relevant circumstances" are leading to RBU receiving a more competitive price than that offered to Synergy's retail competitors. Kleenheat would support removal of this carve out so that Synergy's WBU cannot offer wholesale electricity to Synergy's RBU on terms more favourable to other retailers in any circumstance.

## Improving transparency of balancing markets

- Introduction of facility bidding for Synergy to improve transparency of what is driving the market prices and how competitive or otherwise individual generators are.
- Improved access to and timeliness of AEMO balancing market data including which generators set the balancing price per interval daily.

## Improved dispatch conditions in balancing market

- Allowing shorter re-nomination time-frames for generator bids, in conjunction with facility bidding, would enable a more dynamic and competitive generation market.
- Allowing generators conditional bidding across several hours in order to reduce the risk of mis-dispatch. This would reduce the advantage of baseload generators over peak generators and would improve competition on peak periods of the day.

| Question 5 | What other factors should the ERA consider that may underlie wholesale price |
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|            | increases in the WEM?  |

Capacity utilisation in the market has declined significantly since 2010 and a significant amount of capacity rarely operates and/or is unlikely to operate due to extended start-up times. The cost of this capacity is borne by the market.

A continued review of underutilised capacity should be performed, with large slow-starting generators retired in favour of smaller fast-start alternatives which also better support the continued increase in intermittent and low-cost renewable generation.

*Question 6* Are market participants satisfied that innovation trials are sufficiently open to participation from entities independent of government?

There is significant technology change occurring in the electricity industry including:

- the continued increase in volume and decrease in cost of rooftop PV
- behind-the-meter residential battery storage and load management
- large-scale distributed renewable generation
- small-scale distributed generation, especially to support or offset end-of line issues
- peer-to-peer trading of electricity.

In most of the above cases market participants either find it difficult to participate in the market or are precluded from participating.

Behind-the-meter and peer to peer technologies are continuing to improve but the ability of retailers to offer them in WA is hampered by the lack of full retail contestability (FRC) or, in the absence of FRC, the ability to meter and trade energy with and between customers in the SWIS. Private industry is driving much of the innovation and market growth in these areas in the National Electricity Market.

Large scale renewable projects are increasingly lower cost alternatives to traditional generation but current limitations on where and when they can connect, and access to customer loads to underpin them, is hampering the ability of other participants to enter the market.

Western Power is trialling stand-alone power systems as an alternative to long distance power lines, such as the recent trial in Ravensthorpe. A further 60 sites are planned to be trialled and Western Power has identified an additional 15,000 sites where customers could benefit from stand-alone power over the next decade. Private industry is currently unable to participate in these trials even though there is significant private expertise in WA in stand-alone and/or distributed power systems. Private industry is currently unable to private because of the lack of regulatory access.

Finally, peer-to-peer trading of household generation and/or storage is limited to trials supported by Synergy and Western Power due to the inability of private industry to access and/or update residential meters and provide or purchase energy from residential customers.

Kleenheat is not satisfied that innovation trials are sufficiently open. Kleenheat would participate and potentially invest more in these markets were they open but, like most other market participants, is precluded to them.

| Question 7 | To what extent do market participants rely on, or derive benefit from, the electricity |
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|            | statements of opportunity in planning and investment decisions?                        |

The Electricity Statement of Opportunity is a valuable source of information which helps market participants to understand the fundamentals of the market and form a view on future market dynamics which can offer investment opportunities. However, the report remains largely focused on defining peak capacity requirements for the purpose of defining the Reserve Capacity requirements and lacks analysis of the wholesale energy market and its likely future trends.

Question 8 Should market participants signal intended or probable plant retirements at least three years in advance, as has been suggested in the National Electricity Market; or, should the market operator undertake its own analysis of the probable plant exit dates?

Market participants should be required to signal intended plant retirements at least three years in advance, especially while a significant portion of capacity is owned or controlled by Synergy. The lack of clarity around when or if existing capacity will retire hinders the ability of private industry to make investment decisions to add new capacity and continues to entrench Synergy's market dominance.

The lack of public clarity on generation capacity has been reported several times in recent years, including the approval for Synergy to build its Warradarge wind farm and the lack of public clarity regarding it, and more recently the decision to allow Synergy to keep two fossil fuelled generators for network support.

| Question 9 | If not advanced notice of plant retirements, what other mechanisms could be used |
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|            | to signal investment opportunities and improve the operation of the capacity     |
|            | mechanism?   |

Private investors need confidence that the process by which capacity is approved and paid for is open, competitive and robust, and that the associated market isn't influenced by political decisions.

Confidence in the capacity market has been damaged in the past as a result of factors such as the effectively non-dispatchable DSM, the decision to refurbish Muja AB power station in 2009, the approval for Synergy to build its Warradarge wind farm and the lack of public clarity regarding it, and more recently the decision to allow Synergy to keep two fossil fuelled generators for network support.

| Question 10 | To what extent do policy uncertainty and behind-the-meter changes in generation |
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|             | and storage influence decisions to develop projects in the WEM?                 |

Behind-the-meter technologies are maturing rapidly and are being installed and receiving government support in several states connected to the NEM. Opportunities in WA to provide behind-the-meter services are currently hindered due to the lack of supporting regulation and policy uncertainty.

The lack of FRC and/or regulations allowing third parties access to residential connections and metering prevents many behind-the-meter services from being developed in WA.

Electricity markets globally have typically developed into vertically integrated gentailer markets and it may be that these gentailers will include the provision and management of behind-the-meter services to help balance and hedge their generation/demand portfolios. Market participants other than Synergy in WA are currently unable to develop such solutions and are therefore less likely to develop projects.

Question 11 Do market participants consider the investment environment in the WEM is challenging? If so, why?

The investment environment in the WEM is challenging due to a lack of certainty around regulatory reform and changing timelines, and the lack of confidence that future government decisions will not be made which negatively impact potential investments.

For private industry to invest significantly in the wholesale electricity market, it needs long-term regulatory certainty or stability, and the ability to underpin the sale of the energy generated through either offtake agreements with retailers (predominantly Synergy) or access to customers through a retail market.

Section 54 of the Electricity Corporations Act 2005 and the associated Government Gazette No 137 prohibits anyone other than Synergy or a subsidiary of it from supplying electricity to customers who consume less than 50 MWh per annum, typically small business and residential customers. The removal of this restriction, to enable other retailers to provide electricity to these small use customers, is referred to as full retail contestability.

FRC has been on the road map to be introduced for many years, starting in earnest in 2014 when then Minster Mike Nahan initiated a review of the Wholesale Electricity Market and recommended FRC be introduced. To date no progress has been made on FRC and plans to introduce it were delayed further in 2018 by then Energy Minster Ben Wyatt.

Since Kleenheat entered WA's residential natural gas market, it has become very competitive and competition has brought significant savings to consumers over recent years. Competition has the potential to deliver similar improvements to the electricity market.

| Question 12 | Do market participants consider the investment environment in the WEM will      |
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|             | improve or worsen over the short to medium term? If so, what factors will drive |
|             | this change?  |

Opportunities exist to invest on a small scale, as evidenced by the number of typically less than 100 MW renewable projects; however, investment in larger scale dispatchable generation is unlikely in the current environment.

Larger scale investment will require a decrease in the dominance of Synergy in the market, regulatory certainty and confidence that it will remain, and access to customers.

| Question 13 | What is the likelihood that the State Government will need to invest to replace |
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|             | generation assets?  |

As outlined in the response to question 12, it is unlikely that large scale private investment will enter the market unless regulatory change is implemented to enable access to customers and reduce Synergy's market dominance, or Synergy contracts offtake from new generation capacity. Absence of reform, it is likely the State Government will need to invest in new large-scale generation capacity.

Question 14 What could organisations such as the ERA, AEMO, Western Power and the State Government reasonably do to improve the investment environment?

#### Reduce Synergy's market dominance

To improve the investment environment in the WEM, the ERA, AEMO etc should:

- a) improve transparency into the current market, including initiatives such as facility bidding;
- b) provide a road map of policy reform which the market can have confidence in; and
- c) implement regulatory change in order to reduce Synergy's market dominance and increase market competition.

Provide transparency and give the market confidence around Synergy's market operations until its market dominance is reduced

Page 5 of the report states that the ERA has "graphed publicly available data on fuel prices" and page 6 states "...Synergy's portfolio bidding masks the identity of price setting units within a tranche of generation."

For years, since the re-merger of Synergy and Verve, there has been discussion around adding measures to address Synergy's market power including requiring it to bid on a facility basis rather than its current requirement to bid on a portfolio basis. As outlined in the 2016-17 ERA report, *"Facility bidding would mitigate stakeholder and investor concerns about the transparency and efficiency of ancillary services provided by Synergy and reduce the potential for Synergy to exercise market power".* 

While data on fuel prices is confidentially sensitive to Synergy, given Synergy's market power the ERA should be given access to fuel prices as well as Synergy's information on short-run marginal costs. Assuming facility bidding is not introduced in the short-term, bidding curves of Synergy's facilities should be monitored in order to ensure Synergy is not misusing its market power and to provide satisfactory assurances to competitors and the broader public that this is the case.

#### Allow access to customer's connection

Prior to FRC being implemented, other retailers could be given access to customer meters to facilitate innovation in behind-the-meter and peer-to-peer market development.