



22 November 2007

Mr Robert Pullella
Executive Director
Economic Regulation Authority
Via e-mail: wemreview@era.wa.gov.au

Dear Mr Pullella,

Review of the Operation of the Wholesale Electricity Market

The Energy Supply Association of Australia (esaa) is pleased to provide the following input into the Economic Regulation Authority's (ERA) annual Wholesale Electricity Market (WEM) assessment of the effectiveness of the WEM in meeting the Wholesale Market Objectives (the "Objectives").

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of more than 40 electricity and downstream natural gas businesses, including major generators, network businesses and retailers in Western Australia. esaa member businesses own and operate some \$110 billion in assets, employ over 40,000 people and contribute \$14.5 billion dollars directly to the nation's Gross Domestic Product.

The WEM is a relatively new market and is substantially different in structure to the energy-only gross-pool National Electricity Market. Thus, it would be premature to draw substantial evidence-based conclusions with respect to the effectiveness and efficiency of the Western Australian market in meeting the Objectives. esaa therefore agrees with the ERA view that major structural change of the wholesale market would not be justified at this point without a wider consultative process¹. Nonetheless, in earlier submissions to the Discussion Paper, a number of market participants have raised concerns regarding the Reserve Capacity Mechanism and the Short Term Energy Market (STEM) that could indicate potential dynamic and market inefficiencies.

- With respect to the Reserve Capacity Mechanism, it was suggested that:
 - market pricing outcomes may provide inefficient signals, particularly with respect to mid merit plant requirements, potentially resulting in over-investment in peaking plant. Ongoing monitoring is therefore required with respect to the appropriateness of market pricing signals for peak, mid merit and baseload plant investment decisions; and
 - the two-year timing of the capacity certification cycle is insufficient to deliver new investment, particularly for baseload and mid merit plant, which typically have longer development lead times.

¹ Discussion Paper: Annual Wholesale Electricity Market Report to the Minister for Energy, p. 4

- It was noted also that the inflexibility of the day-ahead STEM to accommodate rebidding as a result of unforeseen circumstances discourages trading in the STEM. Further market consultation is required to introduce either a two-gate closure or replacing the STEM with a real time competitive balancing system.

Future market structural changes should be considered if further evidence of such market efficiencies emerges as the market matures to ensure the Objectives are met in the longer term.

Effective and efficient market governance would be better facilitated by a clear demarcation in the roles of rule making and market administration. It is noted that cost considerations were a factor in making the IMO responsible for rule change proposals in the Western Australian market in addition to market administration, and esaa is cognisant of the current procedures set out in the Market Rules to address potential conflicts of interest arising from the joint roles. However, administrative separation is necessarily suboptimal to structural separation, and may result in perceived conflicts of interest which would be avoided if the roles were clearly separated.

Whilst outside the scope of this Review, impediments to competition – such as the lack of cost reflectivity in retail prices, retail price regulation and the Vesting Contract – inhibit the scope for cost reflective price signals to contribute effectively to the efficient operation of the market and the realisation of the Objectives. Removal of these impediments as soon as is practical would greatly improve the effectiveness of the WEM. It is noted that the Office of Energy is considering retail price issues in the Electricity Market Review, which is currently underway.

esaa notes the apparent difficulty in securing short-term gas supply contracts for electricity generation projects and the potential impacts on electricity supply reliability. In its submission to the Joint Working Group on Gas Supply, esaa supported the market-based approach adopted in the report in developing recommendations to address potential impediments to the competitive supply of gas to the domestic market in Western Australia. esaa supports the proposal that direct government intervention in the market would be counter-productive in the long term. esaa contends that the market is best-placed to determine the most appropriate generation fuel mix in light of available fuel resources, prices and opportunity costs.

Overall, esaa welcomes the report and looks forward to further consultation on these important matters.

Yours sincerely

Brad Page
Chief Executive Officer