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Discussion Paper: Annual WEM Report to the Minister
Economic Regulation Authority
PO Box 8469
Perth Business Centre
PERTH WA 6849

Dear Sir

**VERVE ENERGY'S SUBMISSION TO ERA'S DISCUSSION PAPER: ANNUAL
WHOLESALE ELECTRICITY MARKET REPORT TO THE MINISTER FOR
ENERGY**

Verve Energy welcomes the opportunity to comment on the Economic Regulation Authority's discussion paper on "Annual Wholesale Electricity Market Report to the Minister for Energy". Verve Energy's views expressed in this submission should be considered in conjunction with the discussions held during our stakeholder consultation in May 2008.

Verve Energy looks forward to being involved in the longer term development of the Wholesale Electricity Market (WEM).

Yours sincerely

**ANDREW EVERETT
MANAGER STRATEGY & REGULATION**

Discussion Point 1

The Authority invites comment on the impact of fuel supply and fuel prices on the market. In particular:

- **to what extent, and in what way, do current issues in regard to fuel supply or fuel prices impact on long-term investment decisions in the market; and**
- **to what extent, and in what way, do current issues in regard to fuel supply or fuel prices impact on the day-to-day operation of the market, and outcomes in the market.**

Issues with fuel supply and fuel prices in the long term have created uncertainty in the market. Verve Energy agrees that investors are in the best position to determine the commercial viability of projects and the appropriate plant and fuel type.

In day-to-day market activities, fuel supply issues have contributed to an increase in the difference between cleared prices and what would be considered cost-reflective prices. The timing of STEM submissions and notification of fuel availability has seen generators having to determine bids and offers using the best knowledge of fuel availability at the time. Subsequent fuel curtailment may lead to under-recovery of costs.

Gas supplies are tight but investment decisions will be made accordingly. This could lead to a less than optimum mix of plant in the medium term (eg lack of mid-merit gas fired plant if excess distillate peaking plant built in interim). There is also a potential issue if price caps and SRMC bidding prevent appropriate cost recovery, particularly for mid-merit plant.

Most issues relate to curtailment of supplies re discussion point 2. One point is that the Maximum STEM Price is only reviewed annually. There is no ability to adjust the cap to accommodate short term fuel price spikes (eg gas at \$15-35GJ during the recent Varanus Island incident). This has resulted in participants being forced to sell energy below SMRC.

Discussion Point 2

The Authority invites comment on the impact of fuel constraints on the market. In particular:

- **to what extent, and in what way, do fuel constraints impact on the day-to-day operation of the market, and outcomes in the market;**
- **to what extent, and in what way, does the design of the market exacerbate problems caused by significant fuel constraints; and**
- **do current issues in regard to gas supply interruptions deter participation in the STEM.**

Generators face a significant risk that bids and offers posted a day ahead (STEM) may not reflect actual costs due to fuel curtailments. This generally results in under-recovery of costs. As the balancing provider, Verve Energy is particularly exposed as it is paid based on its STEM submissions whereas an IPP dispatched for balancing will be paid based on the fuel it used (liquid/non-liquid).

Further, the dispatch of Verve Energy plant ahead of other IPP generators leads to dispatch that does not encourage the achievement of the market objectives and this is amplified during times of fuel constraint.

With respect to bullet point 3, it should not have any significant impact, particularly for market generators who are obliged to participate anyway.

Discussion Point 7

The Authority invites comment on the extent to which the reserve capacity mechanism, along with other elements of the WEM, provides appropriate incentives for investment in a mix of new generation plant. The Authority is interested in specific factors that might have deterred potential new investment in the market.

There is some concern that the Reserve Capacity Mechanism (RCM) does not provide appropriate incentives for a diversity of new generation plant, particularly mid-merit plant. RCM strongly promotes the installation of peaking plant.

Although it may be too early to assess, there is a concern that SRMC bidding, price caps and RCM payments will discourage entry of mid-merit plant, leading to higher overall energy costs

Discussion Point 9

The Authority invites comment on the extent to which the methodology for calculating reserve capacity refund payments promotes the market objectives, particularly in regard to reliability of supply. In particular:

- **to what extent do participants respond to signals provided by the structure of reserve capacity refund payments; and**
- **if reserve capacity refunds reflected their impact on the market, how would this be expected to affect compliance or incentives to participate in the reserve capacity mechanism.**

The reserve capacity refund payments provide strong signals to market participants to maximise plant availability, minimise outages and return plant to service in a timely manner. It could be argued that the current levels are more than adequate and are adversely impacting on maintenance practises and the sometimes overly hasty return to service of plant at excessive cost.

Verve Energy supports a move to market-based reserve capacity refunds. Such an arrangement would encourage plant availability when it is most highly valued. That is desirable. The current mechanism is overly skewed towards the summer peak period while other times of the year, for example in the shoulder periods when there are a greater number of planned outages, supply risk is not sufficiently discouraged. Market equilibrium from the advent of a market-based arrangement should result in the appropriate level of compliance.

Discussion Point 10

The Authority invites comment on the effect of moving the STEM closer to real-time or of introducing multiple gate closures. In particular:

- **would this encourage greater participation in the STEM or improve outcomes in the STEM, including through improved price signals;**
- **would the benefits to participants outweigh the costs to participants; and**
- **what, if any, barriers are there to such a change and what do these barriers suggest for the timing of such a change.**

Verve Energy supports a mechanism that allows rebidding in the STEM to appropriately reflect circumstances that occur due to plant availability and fuel interruptions. This would lead to more economic and efficient dispatch, with cost reflective prices, and reduce discrimination between participants.

Verve Energy considers that the suggested changes would not significantly influence participation in the STEM but that there would be some increase in volume with increased price certainty.

Discussion Point 11

The Authority invites comment on the extent to which Verve Energy's exposure to forecasting errors in the balancing market impacts on the effectiveness of the market.

The Authority invites comment on barriers to the introduction of competitive balancing, and what these barriers suggest for the shift to more competitive balancing arrangements.

The difference between day-ahead forecasts and real time dispatch can lead to uneconomic outcomes. This is primarily due to the dispatch merit order where Verve Energy plant is dispatched first when lower cost IPP plant may be available.

The current determination of balancing prices does not adequately reflect the costs associated with balancing and it is important that cost-reflective balancing prices are achieved. Verve Energy supports the introduction of a competitive balancing market.

Discussion Point 12

The Authority invites comment on the delivery of ancillary services, particularly in regard to the competitive delivery of ancillary services.

Verve Energy supports the competitive delivery of ancillary services which goes hand in hand with competition in balancing services.

Verve Energy supports a review of the payment mechanism for ancillary services. The current methodology exposes Verve Energy to increased risk of revenue under-recovery.

Discussion Point 13

The Authority invites comment on the impact that wind energy will have on the effectiveness of the WEM. In particular:

- **to what extent, if any, will additional wind energy impose costs on the market, and will these costs be borne by the wind energy facilities or by other participants; and**
- **do the existing arrangements for network connection charges provide signals to wind energy facilities that reflect the impact of these facilities on the market.**

A significant increase in wind energy penetration may have adverse implications for base load thermal plant overnight. If there are no appropriate pricing signals for participants to shut down generation then it puts increased risk on the security and reliability of the system.

Increasing wind energy penetration drives the need, at significant cost, for additional ancillary services such as frequency control and spinning reserve. Other participants may incur those costs even though they are not directly using the services

Verve Energy notes and supports that this is the subject of a Working Group.

Discussion Point 16

The Authority invites comment on whether System Management remaining within Western Power impacts on the effectiveness of the market and, if so, in what way.

Verve Energy considers that the current arrangements with respect to System Management are satisfactory. Verve Energy does not support the amalgamation of System Management and the IMO.