2016/17 Wholesale Electricity Market Report for the Minister – Stakeholder Consultation

Alinta Energy Submission

1 September 2017

1. Introduction

Alinta Energy (**Alinta**) welcomes the opportunity to provide comment on the Economic Regulation Authority's (**ERA's**) Discussion Paper: 2016/17 Wholesale Electricity Market Report to the Minister.

Alinta notes that the previous government initiated a significant market reform program (the **Electricity Market Review** or **EMR**) to examine:

- the structures of the electricity generation, wholesale and retail sectors within the South West interconnected system (**SWIS**) in Western Australia; and
- the incentives for industry participants to make efficient investments and minimise costs.

While the EMR was underway a number of market development rule changes being progressed under the Wholesale Electricity Market (**WEM**) Rules (**Market Rules**) were placed on hold to allow the Independent Market Operator (**IMO**) to consider the outcomes of the EMR and any potential impacts on the respective Rule Change Proposals. The EMR didn't progress as planned and a number of the market reforms purported to improve the efficiency and competitiveness of the WEM were not implemented. What this means is that, aside from the implementation of the transitional arrangements for the Reserve Capacity Mechanism, there has been little progress in addressing market effectiveness and competitiveness in the last three years.

There has been uncertainty as to the future direction of the WEM for much of 2017 with the change of State Government. To that end Alinta welcomed the Minister for Energy's policy announcements at the 17th Annual Energy in WA Conference and looks forward to receiving greater detail and clarity about these policy reforms as soon as practicable.

Alinta is supportive of Minister for Energy's announcements regarding:

- Reforming the access arrangements for the Western Power network, to make it easier and more cost effective for generators to connect to Western Power's grid, and to ensure that the framework is able to handle advances in technology. In noting this support, Alinta cautions that significant work will be required in the following areas:
    - development of a suitable mechanism to ensure that the past contributions and legal rights of existing network participants are recognised and maintained; and
    - Capacity Credit allocations under a constrained network access model are allocated in a fair and equitable manner and also send appropriate signals.
- The development of operational improvements to the WEM; and
- Undertaking a review to identify the most appropriate mechanism to price capacity rather than automatically moving to a Reserve Capacity Auction - as the EMR assumed. Alinta considers that an appropriate mechanism needs to be sufficiently dynamic and transparent.

In addition to these reforms, Alinta considers that there are a number of immediate improvements to the market that can be made which will result in costs savings for consumers and allow for the WEM to be protected from the system security issues the National Electricity Market (**NEM**) has faced in recent times. These are:

- Immediate reduction in the contestability threshold to 30MWh with a transitional plan towards Full Retail Competition (**FRC**);

- A move from the current market power mitigation arrangements in the WEM from the current ex ante approach (i.e. focus on bidding rules) to an ex post approach that focusses more on outcomes which has benefits of flexibility that are relevant to the nature of the WEM;
- An assessment of the Finkel Review[1] recommendations that should be adopted in the WEM; and
- Improvements to the broader governance framework to:
    - provide greater clarity on the respective roles and responsibilities for each governance/regulatory body. This is required to ensure no conflicts of interest arise and the risk of duplicated functions/costs is minimised; and
    - ensure robust and efficient energy policy development.

Each of these issues is explored in greater detail below.

2. Discussion

2.1 Network access

The role of network access is critical given the evolution of the WEM. Alinta values its current access rights and changes to the current transmission framework without careful consideration could undermine investment incentives, as well as create a loss of asset value for existing access rights holders, if moving away from the existing "unconstrained" model.

Noting this, Alinta recognises that Western Power's ability to connect new large generators to its network under the unconstrained market design has been limited for some time and reform is needed to allow new generators to connect.

Western Australia is an attractive market for renewables investment given the natural resources and the design characteristics, with a number of renewables investments looking to connect in the WEM for many years. The failure of the progression of the Network Bills as part of the EMR meant that industry leadership was required during 2017 to allow new generators to connect to the network in a timely manner and for those new generators, to facilitate the ability to obtain Reserve Capacity revenue. To that end, Alinta appreciates the work by Government, Western Power, the Public Utilities Office (**PUO**) and the Australian Energy Market Operator (**AEMO**) to facilitate the connection of new generation under the Generator Interim Access (**GIA**) solution.

Alinta considers that the GIA solution is a good first step to moving to a constrained network access model. It will assist with the State's ability to meet its national Renewable Energy Target obligations in coming years, which in turn should provide significant local employment opportunities.

However, Alinta recognises that this is (appropriately) an interim arrangement and therefore supports the current Market Rule requirement for AEMO to assess the GIA arrangements for the 2019 Reserve Capacity Cycle. This review should include a thorough assessment of market outcomes under the GIA two- tiered network access arrangement and how this arrangement has contributed (or not contributed) to the achievement of the market objectives.

[1] *Independent Review into the Future Security of the National Electricity Market: Blueprint for the Future*, Commonwealth of Australia 2017: http://www.environment.gov.au/energy/national-electricity-market-review

Alinta notes that a move to a fully constrained network access model should theoretically:

- Promote economically efficient supply of electricity by encouraging investment in assets with high utilisation levels, for example, by sending appropriate locational signals;
- Remove a barrier to competition, as new entrants wouldn't be required to pay network augmentation costs; and
- Minimise the long term cost of supply.

Noting this there are impacts on both the energy and capacity mechanisms in the WEM which need to be thought through in great detail. Specifically new entrants will impact on existing generators (including earlier new entrants) for capacity accreditation purposes unless expressly addressed in the design. This is an unhedgeable risk which undermines past investment decisions and will inhibit future investment in both the WEM (and the network).

Therefore, as part of any move to a fully constrained network access model significant work will need to be undertaken to ensure the development of suitable mechanisms:

- development of a suitable mechanism to ensure that the past contributions and legal rights of existing network participants are recognised and maintained; and
- Capacity Credit allocations under a constrained network access model are allocated in a fair and equitable manner and also send appropriate signals.

Alinta considers that grandfathering arrangements must be provided to ensure the ongoing integrity of the RCM and to recognise past investments of existing generators under the previous legal and contractual arrangements agreed to with Western Power; while at the same time not diluting or delaying the benefits of the move to a constrained network more broadly.

Alinta considers that the following objectives should guide the design of any grandfathering arrangements:

- Objective 1 - To protect the ability of participants to receive Capacity Credits to a level that is reflective of the investments in network capacity they have made under the previous legal model.
- Objective 2 - To mitigate any sudden changes to prices or margins for market participants on commencement of the new arrangements.
- Objective 3 - To ensure distortions to the RCM design are not introduced, including unintended cross-subsidies.

Alinta looks forward to working closely with the relevant agencies to ensure that these arrangements are fit for purpose and adequately recognise existing participants' rights and contributions.

While conceptually supporting the move to a fully constrained network access model (subject to the successful consideration of the above issues), Alinta remains concerned that industry has yet to be provided with any modelling information on the level and location of constraints in the WEM. Alinta considers that ideally the outcomes of constraint modelling should be made available to the market to enable the market to make efficient investment decisions. If full details of the modelling are unavailable due to confidentiality concerns, Alinta strongly considers that the ERA recommend that

Western Power release its modelling assumptions for stakeholder consultation. This will allow participants to gain a sense of comfort that the modelling is based on sound inputs and assumptions. The ERA quite rightly raises an important issue about the treatment of unconstrained access following the retirement of generation facilities and questions whether this unconstrained access should become available to other generators or new generators in the network once these generation facilities close.

Alinta strongly considers that unutilised unconstrained access should be available to other generators (i.e. there should be a use it or lose it aspect). Alinta considers that holding unconstrained access as a strategic asset will crowd out new entrants/investment; if new participants have to enter on a constrained basis, when there is unconstrained access available, but unused, inefficient investment outcomes occur and consumers will pay the price of these inefficiencies.

2.2 Operational improvements to the WEM

Alinta considers that there are a number of operational improvements that should be made to the WEM in the near future to ensure that it continues to develop as an efficient and competitive market. These improvements should include:

- Requiring Synergy to make submissions for each of its facilities so that it is dispatched on the same basis as other participants' facilities (including the form of submissions, gate closure, surveillance etc.);
- Reducing gate closure times;
- Implementation of co-optimised energy and ancillary services markets; and
- Improving the dispatch engine. Noting this, Alinta does not support the automatic assumption, which was made under the auspices of the EMR, that the National Electricity Market Dispatch Engine (**NEMD**E) should be the dispatch engine adopted in the WEM. While Alinta recognises that there is benefit in aligning system solutions where possible across jurisdictions, Alinta notes that NEMDE will need to be modified to take into account the STEM and the RCM, therefore AEMO should be required to assess the most appropriate and cost effective dispatch solution for the WEM.

Alinta considers that this development work should be progressed as a matter of priority, noting that implementation is likely to take a number of years.

2.3 Reserve Capacity Price mechanism

As part of its submission into phase 1 of the EMR Alinta specifically recommended that a capacity auction should not be adopted to solve the identified issues in the market. Alinta considered that doing so would likely introduce a new range of issues into the market which would require addressing and it is unclear that there would be any additional benefits associated with implementing an auction that could not be achieved through a refinement of the existing market design.

Specifically, Alinta noted that the implementation of a capacity auction in the WEM would:

- Not deliver any greater efficiencies to the market than a refined administered pricing regime;

- Introduce a new set of associated risks, particularly given the potential for more volatile pricing outcomes to which a number of existing generators will be exposed as a consequence of the limited incentives for bilateral contracting under the current regime;
- Require the current issues associated with Synergy's continued dominance in both the retail and wholesale market to be addressed through a disaggregation and privatisation process; and
- Require both significant design work and a reasonable transition for existing participants.

This view has not changed, and to that end, Alinta welcomes the Minister for Energy's statement that a Reserve Capacity Auction won't occur in the WEM until a fundamental review is undertaken to assess what the most suitable pricing mechanism is.

Alinta looks forward to working closely with the relevant agencies to ensure that the most appropriate capacity pricing mechanism is implemented for the WEM, noting that Alinta considers that the mechanism adopted needs to be both sufficiently dynamic and transparent.

2.4 Retail Electricity Market Reform

There are a number of improvements that should be made to the existing retail electricity market to address some of the inefficiencies and costs in the market. To date, competition has been introduced in WA's electricity market via staged reductions in the threshold for contestability. Alinta believes that continuing to adopt this staged approach to FRC is desirable, offering the most cost efficient solution while maximising the consumer benefit.

Deregulated electricity markets drive the best outcomes for consumers as they promote competition and customer choice. Open, competitive retail energy markets, free from distortions such as government price setting, promote efficient pricing through the development of market offerings. Competition in retail energy markets, as in other sectors of the Australian economy, incentivise businesses to improve service, develop products that meet consumer needs and find lower cost solutions with savings that are ultimately passed on to consumers. Implementation of FRC will deliver these benefits to WA consumers.

Moving towards FRC and ensuring a clear pathway for the further evolution of the retail market in WA should be an active and immediate consideration. To this extent Alinta recommends that a phased approach be adopted. A high level overview of Alinta's suggested approach for the further evolution of the retail market is provided below:

- **Phase 1 – Reduce the contestability threshold to 30MWh immediately**

  An interim step of reducing the contestability threshold to 30MWh and making unmetered supplies fully contestable should be implemented immediately. This interim step would:

  - Enable an estimated additional 10,000 customers to select their electricity retailer of choice;
  - Retain current systems and processes to enable contestable customers to subsequently take up a competitive offer (including transfer systems and the requirement to install interval meters); and
  - Facilitate the development of a stronger base from which the extension of competition to all consumers could be achieved.

A staged approach to FRC allows sufficient time for the orderly development of systems and processes necessary to enable customer churn in the residential market whilst still providing choice to business customers.

- **Phase 2 – Introduction of FRC**

  The industry should continue preparing for the introduction of FRC to enable all customers to select their electricity retailer of choice as soon as practicable.

  To facilitate the introduction of FRC, consideration will need to be given to the current market structure, cost reflectivity, development of independent price regulation and introduction of systems and processes to facilitate a greater level of customer churn.

  Alinta anticipates that it will take a minimum of 2 years to develop independent price regulation and introduce any other necessary systems and processes to allow a large volume of customers to switch retailers.

  Alinta considers that should tariffs not be cost reflective at the time FRC starts, subsidies currently required under the Tariff Equalisation Contribution (**TEC**) and uniform tariff policy should be paid via the network operator rather than directly to Synergy, so as to ensure a level playing field for retailers. This is consistent with decisions in the NEM, where it has been agreed that general government subsidies should be provided via network costs rather than at the retailer level.

  Alinta believes that the current consumer protection framework applicable to small use customers will provide both adequate and effective protection when FRC is implemented. However, there is merit in undertaking a comprehensive review of the concessions framework and the regulatory processes for managing bad debt and disconnections will require further consideration prior to the introduction of FRC.

  Alinta is aware the government previously considered whether contestable metering should be a precursor to FRC. Alinta believes FRC will be successful without contestable metering, as has been the case in the NEM and the WA gas market. The option to introduce contestable metering can be considered after FRC has been introduced. However, it's important that any decision by network operators today regarding the bulk replacement of meters does not preclude contestable metering from being introduced in the future by making the network operator the only obvious owner of the meters going forward.

  Finally, the establishment of retailer of last resort (**ROLR**) provisions, which aim to protect customers in the event of a retailer failure, is not viewed by Alinta as a pre-requisite to FRC. ROLR schemes in other jurisdictions have been developed following the implementation of FRC and regulators have, in the interim, relied upon the assistance of more established retailers in taking on customers in the unlikely event of retailer failure. It should be noted that a supplier of last resort is yet to be designated by the ERA for the WA retail gas market.

- **Phase 3 – Review of effective competition after the introduction of FRC**

  Following the implementation of FRC, Alinta considers that the next phase in the retail market's evolution should look to assess the effectiveness of competition with a view to removing price regulation and considering the continued relevance of the Gas Market Moratorium.

Alinta considers that the Gas Market Moratorium should only be removed when competition in the electricity market is determined, by an independent body, to be effective. In making this decision the following matters should be considered:

- Whether prices for electricity are fully cost reflective;
- Whether competitive neutrality between State Government owned retailers and privately owned retailers is established;
- Whether the market structure and rules fully support competition (removal of any unnecessary impediments to customer transfers); and
- The level of customer churn and whether the regulatory and policy environment is considered stable.

2.5 Market Power Mitigation arrangements

Alinta supports a competitive, dynamic market founded on clarity, stability, and transparency. To ensure that the broad market design effectively delivers greater efficiency and competitive outcomes market participants must be able to compete actively in the market. Overly restrictive bidding constraints undermine the benefits of effective competitive dynamics in the generation sector.

The continued dominance of Synergy in the WEM means that market power will remain a headline concern; however Alinta considers government ownership to be a significant mitigating factor in respect of market power abuse. Consequently, Alinta considers a more permissive approach to bidding behaviour ex-ante (before price formation) can and should be adopted to support more dynamic and genuine competition in the market, while utilising the monitoring and review powers of the ERA to identify any materially concerning outcomes that require further investigation.

The greater concern in industries with substantial government ownership, is not market power abuse, but rather how to ensure that government-owned entities will operate in a commercial manner. Market power is a second order concern in such cases from an economic efficiency perspective. Our view is that if Synergy were ever to be privatised, it would need to be split into two or three entities to promote transparent, competition-based behaviours and outcomes[2]. However, as long as Synergy is government-owned, Alinta does not see abuse of market power as being a particularly concerning risk.

Given this context, the WEM's market power mitigation arrangements can and should be redesigned to better reflect regulatory practice elsewhere in the world through enabling more flexibility, reducing current levels of intrusiveness, and seeking to achieve a sustainable balance between market power concerns and the need to maintain system adequacy and security of supply. Put

[2] Splitting up a government-controlled entity into multiple government-controlled entities is a way to mitigate some concerns over potential non-commercial behaviour and promote a more commercially robust market. Most countries that have retained government ownership within the electricity generation and retail sectors (while also introducing competitive wholesale markets) have restructured around multiple government-controlled entities, mimicking a competitive, long-term market structure, enabling the option to privatise entities in the future, and promoting easier comparisons and greater transparency of behaviours. Consider the experiences of eastern Australia (NSW and QLD for example), New Zealand, Singapore, South Korea, the Philippines, and the evolving direction in Malaysia, to name a few.

simply, the current short-run marginal cost (SRMC) bidding rules signal a fundamental lack of confidence in the broader market arrangements.

Specific details of Alinta's recommended reforms are presented below. These are based on the independent advice of The Lantau Group. The recommended changes represent a better way to express concern for possible abuse of market power as it places more trust on market competition where possible while allowing for appropriate actions to be taken where necessary. The alternative approach which has been adopted in the WEM to date relies more on ex-ante bidding restrictions with considerable associated ambiguity as to how those restrictions are to be interpreted.

The proposed reforms are consistent with best practice internationally, while also reflecting an important and valuable modification to the way market power is mitigated in the WEM today.

2.5.1 Alinta's proposed reforms

- **Evolution of the market oversight role of the ERA towards a greater focus on ex-post inspection**. This is because ex-post inspection should have priority over ex-ante restrictions.

  While Alinta recognises that ex-post review introduces risk in terms of ambiguity as to what outcomes will be reviewed, ex-ante restrictions introduce risk in terms of whether the restrictions are consistent with relevant underlying costs and values. Alinta believes that the ERA can manage these risks appropriately and that a focus on ex-post review provides a better basis to evaluate market performance and competitive dynamics.

- **Explicit recognition that market power is not the only concern that may arise in relation to market bidding and price formation** and therefore should not continue to be the only focus of the Market Rules pertaining to bidding and pricing.

  The other important concern from a design perspective is that prices must be high enough to support timely and efficient behavioural and investment responses. Consequently, a focus only on market power, with a view to ensuring that prices are as low as possible, introduces into the design the risk that prices will be constrained too low. Regulatory oversight of market prices should be equally alert to both concerns – balancing them accordingly when evaluating outcomes.

- **Removal of the current detailed definition of SRMC and broadening of scope of specified mitigation controls.**

  Although SRMC is theoretically the optimal bidding price in a fully competitive market (given static equilibrium conditions), it is well-known that estimation of SRMC is not always simple, and that markets are dynamic and have self-correcting incentives over time. We do not consider it is possible to develop a clarified set of detailed guidelines for calculating SRMC that fully captures the challenge of estimating appropriate SRMC-based bids at all times. Consequently, we consider any guidelines need to be "higher level", which implies the need for greater flexibility.

  The WEM is a self-commitment market in which start-up costs are recovered through accepted energy market offers. For mid-merit and peaking capacity, at minimum, the appropriate SRMC bid can vary widely depending on expectations concerning how long a given start-up to shut-down cycle will run.

- **Implementation of a reference level trigger for review of bids by the ERA to confirm whether they were competitive.**

  Consistent with best practice in other markets, we support a safe harbour concept for bids that are within at least 20% of reported levels subject to considering the need to recover start-up costs, the opportunity cost associated with limited fuel supplies, and other similar costs.

  Alinta does not believe it is necessary (and is instead mutually burdensome) to provide cost data to support every bid in each hour. Instead, we suggest the adoption of a reasonable standard benchmark cost range. If a unit has materially higher costs, then application can be made for appropriate exceptional treatment. Note that adjustments to the benchmark level as a result of changing fuel costs would be required potentially.

  Alinta supports a reference level set based on cost stack plus ~20%. We consider that adopting at least 20% as a level to trigger a review would be required as start-up costs are incorporated into bids within the WEM and so a larger level of volatility in bid levels is possible than in other jurisdictions which adopt 10%.

  The appropriateness of the reference level should be subject to occasional review by the ERA to ensure that reviews of bids are being triggered at appropriate times. To the greatest reasonable extent, the reference level should be set as high as practicable so as to allow competition dynamics to work.

  A problem with the current arrangements is that they do not allow any natural evolution towards greater reliance on competition itself, as the Market Rules are explicit about SRMC bid constraints under all market conditions. We note a more flexible approach would be to allow the use of overall bid caps as seen in other markets and for those caps to be evaluated and revised as appropriate.

- **Consideration of implementing scarcity pricing arrangements.**

  The rebalancing between the energy and capacity mechanisms means that energy pricing plays an important role in signalling readiness, and ensuring system adequacy and security can be maintained during contingency arrangements. Higher energy prices during contingency events are not simply about signaling investment in capacity.

  Best practice in several markets is to implement special scarcity pricing arrangements which result in a relaxation of bid constraints or other market power mitigation measures under situations where there is deemed to be a high risk of an outage. Such arrangements seem particularly appropriate for the WEM, particularly, given the small, lumpy, and volatile nature of the market.

- **Retain Gross Cost of New Entry (CONE)[3] approach for determining the Benchmark Reserve Capacity Price** given the peakiness of SWIS which makes it difficult to reconcile any assumed "net" energy market revenue for peaking capacity.

[3] CONE is an estimate of the unit cost of (installed) capacity for the most economical form of new construction, excluding variable energy costs. Gross CONE includes all fixed costs related to the construction and availability of a facility, including those related to capital, financing and fixed OM&A. Net CONE equals gross CONE minus the expected margin on sales.

If in the future Net CONE were to be adopted, much higher energy bid caps would be required as any material net revenue for peaking capacity in the energy market would necessitate much higher market prices as the market approaches scarcity in order to represent a material contribution to the cost of new entry.

2.6 Planning for increased levels of intermittent generation in the WEM

Alinta considers that the WEM can manage the transition from thermal to renewable generation in a manner that maintains Western Australia's energy security. However, this will require sufficient dispatchable generation, inertia and ancillary services to maintain security and reliability.

While the Finkel Review addressed the National Electricity Market solely, it did state, "the Western Australian and Northern Territory governments should consider adopting the Panel's recommendations for their individual electricity systems"[4].

Alinta considers that the WEM is in a privileged position to be able to learn from the recent NEM issues regarding managing increased levels of intermittent generation. Now is the time to plan and prepare for the future to ensure the WEM does not experience the same security and price issues as the NEM. As such, it is appropriate for the ERA to identify the report's recommendations which should be considered for Western Australia.

At a high level, Alinta considers that there are a number of recommendations which have merit for Western Australia, such as the:

- Energy security obligations (Recommendation 2.1) – noting that Alinta would recommend a market based approach to procuring inertia for the WEM rather than the recommendation that the TNSP procures this service;
- Data collection framework on distributed energy resources (2.6);
- Resilience to human/environmental threats, cyber security (2.7 & 2.10); and
- Energy infrastructure and demand forecast accuracy (2.11).

Other recommendations such as tighter governor response (2.2) and system restart plans (2.4) are already in place in the WEM.

Alinta notes that there are a number of recommendations that are unnecessary for the WEM given the current market design, such as a generator closure notification (3.2), generator reliability obligations (3.3), strategic reserve & day-ahead market (3.4) and expediting and optimising the rule change process (7.9 & 7.10).

Finally, while greater planning and coordination is required between the different regulatory bodies in Western Australia (as identified below), Alinta does not consider that there is a need for an additional regulatory body, such as the Energy Security Board (**ESB**), in Western Australia. However, consideration should be given to developing a Statements of Expectations for the ERA and the Rule Change Panel, and a Statement of Role to the AEMO containing a comprehensive set of outcomes-based performance indicators (as per recommendation 7.5).

[4] *Independent Review into the Future Security of the National Electricity Market: Blueprint for the Future*, Commonwealth of Australia 2017, p. 29

Alinta would be happy to participate in a more detailed discussion around the relevance of the Finkel Review recommendations for the WEM.

2.7 Improvements to governance frameworks

In its discussion paper the ERA indicated that it is interested in stakeholder views on arrangements for oversight and/or coordination of planning and market development in the WEM.

Pre-EMR the governance framework for Western Australia was characterised by a number of conflicts, particularly with respect to rule making and enforcement, which needed to be addressed. Further, there was a duplication of functions, notably market operation functions and compliance and monitoring functions. These conflicts and duplications are generally inefficient.

As part of the EMR Alinta supported the development of an alternative governance framework that:

- Removed identified concerns around conflicts of interest;
- Improved transparency and robustness;
- Achieved greater operational effectiveness; and
- Resulted in cost savings to the market through improved efficiencies.

Specifically Alinta advocated:

- Removing the compliance and rule making functions for the market from the IMO to:
    - The Australian Energy Market Commission, through a dedicated Perth based branch, which would be the standalone rule making body in the WEM; and
    - The ERA to become the standalone compliance and enforcement body in the WEM; and
- The IMO should become a standalone market and system operator, incorporating System Management's current roles and responsibilities within the WEM.

The EMR implemented a number of changes to the institutional arrangements in the WEM, including:

- Establishing the regulatory framework enabling a new Rule Change Panel (**RCP**) to undertake the administration and decision-making functions related to proposed changes to the Wholesale Electricity Market Rules and the Gas Services Information arrangement. This included the ERA providing secretariat support functions to the RCP;

- Transfer of system management functions to the Australian Energy Market Operator (**AEMO**) to improve the coordination of System Management (including generator dispatch) with the commercial outcomes of the WEM;

- Transfer of compliance and enforcement functions for the Wholesale Electricity Market Rules and Gas Services Information Rules from the IMO to the ERA; and

- Transfer of market operation functions from IMO to AEMO.

The key difference between Alinta's recommendations and the institutional arrangement reform actually implemented under the EMR was incorporating the rule change secretariat services into the ERA rather than establishing a standalone rule making body in the WEM (noting that the RCP and the ERA Governing Body are separate entities).

The reforms to the institutional arrangement have been progressively implemented – commencing with the transfer of market operation functions on 30 November 2015 and finishing with the implementation and operationalisation of the Rule Change Panel on 1 April 2017. Therefore it is difficult to undertake a fulsome assessment as to whether the oversight and/or coordination of planning and market development in the WEM is as efficient and effective as it could be, is free from conflicts (either perceived or actual)[5] and does not duplicate functions and /or costs for the industry[6].

Noting this, Alinta considers that it is timely to undertake further work to ensure that the market does not find itself in the same position as it was prior to the EMR reform in regards to conflicts of interest (either perceived or actual) and duplication of functions. Alinta considers that this work should review the institutional arrangements and ensure:

- That each agency's role is clear – for both the agency itself and the broader industry;
- There are no conflicts of interest and duplication of functions/costs occurring; and
- Robust energy policy development in able to occur in a timely manner going forward.

Specifically, Alinta considers that there needs to be clear delineation between of the roles of the AEMO and the policy-making and regulatory bodies such as PUO and ERA.

Finally, in reviewing and assessing the governance arrangements in the WEM, Alinta recommends that the ERA apply the following seven principles of good governance. Each principle holds equal importance.

1. ***Efficient*** – The institution produces results that meet the market's needs while making the best use of resources.

2. ***Effective*** – The institution has the ability to successfully complete its defined tasks, resolve identified issues and develop a long term perspective of what is needed in the market.

3. ***Fair*** – The institution's legal and procedural frameworks should be fair and enforced impartially; this is especially true when there are commercial outcomes.

4. ***Transparent*** – The institution, its processes and information are directly accessible to those concerned with them and enough information is provided to understand and monitor them.

5. ***Consultative*** – The institution encourages diverse and meaningful public contributions to allow decision makers to consider different issues, perspectives and options when defining a

[5] Given the ERA is now responsible for the compliance and monitoring and rule change secretariat functions (as the IMO was).
[6] Given there is evidence of AEMO, the RCP and the PUO all undertaking market development work.

problem. Good consultation mediates effectively between different interests to reach a broad consensus.

6. ***Responsive*** – The institution and its processes seek to serve all stakeholders in a timely fashion.

7. ***Accountable*** – The institution is accountable to stakeholders. When mistakes have been made, these should be admitted so future mistakes can be avoided.

3. Conclusion

In conclusion, Alinta considers that the reform process initiated under the ERM needs to continue to be progressed to ensure that the Wholesale Electricity Market continues to evolve and become more efficient and competitive, this includes:

- Reforming the access arrangements for the Western Power network, to make it easier and more cost effective for generators to connect to Western Power's grid, noting significant work will be required in the following areas:
    - development of a suitable mechanism to ensure that the past contributions and legal rights of existing network participants are recognised; and
    - Capacity Credit allocations under a constrained network access model.
- The development of operational improvements to the WEM;
- Undertaking a review to identify the most appropriate mechanism to price capacity rather than automatically moving to a Reserve Capacity Auction - as the EMR assumed;
- Immediate reduction in the contestability threshold to 30MWh with a transitional plan towards FRC;
- A move from the current market power mitigation arrangements in the WEM from the current ex ante approach (i.e. focus on bidding rules) to an ex post approach;
- An assessment of the Finkel Review recommendations that should be adopted in the WEM; and
- Improvements to the broader governance framework to:
    - provide greater clarity on the respective roles and responsibilities for each governance/regulatory body. This is required to ensure no conflicts of interest arise and the risk of duplicated functions/costs is minimised; and
    - ensure robust and efficient energy policy development.

Alinta notes that for effective reform to occur a highly consultative approach is required. To that end, Alinta looks forward to actively contributing to the market reform processes going forward.