

15 April 2019

Ms Sara O'Connor
Economic Regulation Authority
Submission by email: publicsubmissions@erawa.com.au

Dear Ms O'Connor

RESPONSE TO ISSUES PAPER – AUSTRALIAN ENERGY MARKET OPERATOR'S ALLOWABLE REVENUE AND FORECAST CAPITAL EXPENDITURE PROPOSAL FOR THE 2019/20 TO 2021/22 PERIOD

NewGen Kwinana welcomes the opportunity to provide comments on the above issues paper (Paper). Additionally, NewGen Kwinana makes some high-level observations on the nature of the allocation of costs associated with 'market reform' and the increasing cost and complexity of the WEM.

Response to Questions:

1. *Given that much of the market design and detail of the systems needed to operate a new market design are yet to be determined, would interested parties prefer to approve the funding:*
 - a. *For the full three years of the AR5 period*
 - b. *Through a staged approach, such as happened in AR4, where AEMO proposes additional funding as clarity and certainty develops through the market reform program?*

NewGen Kwinana suggests a staged approach to approvals due to uncertainty. Over AR4, there were several additional approvals for capex as the extent of reform became clearer, which is implicitly conducting annual approval processes. Therefore, given the extreme uncertainty over the AR5 period, an annual assessment of funding should be sought. NewGen Kwinana also suggest that the whole funding process be performed annually, including the BAU Opex funding. An annual funding process would then mean no additional impost and should provide a better control on costs.

NewGen Kwinana supports the ERA's role in reviewing the Allowable Revenue proposals during the reform program as a key governance measure ensuring the appropriate control measures are in place to only approve efficient expenditure from the revenue collected from Participants.

2. *Which, if any aspects of AEMO's submission are of most concern to stakeholders and why?*

The change to the scope of market fees collected by AEMO is a major concern for NewGen Kwinana in reference to the letter from the Minister¹ as well as AEMO's observations², including the DER Roadmap and Integrated System Plan. The scope is broad and in many cases vague given the present lack of detailed analysis and design. NewGen Kwinana suggest that AEMO is effectively given control over the future structure of the WEM, without any real oversight on whether the

¹ Appendix 1

² Pg 10

systems they adopt are cost effective. This situation is more suited to the shorter regulatory process as noted in Question 1 above.

In comparison to similar reform programs in the NEM, the AEMC, ESB (as part of COAG), AER, ACCC and PC, all provide input into the workings of the national electricity sector and are funded by the governments of the jurisdictions that they service.

In light of the significant change in scope that is being applied to AEMO's remit, it is remiss to overlook the mechanism by which market fees are allocated. As highlighted in both the Minister's letter and AEMO in their proposal, the driver of reform is the rapidly changing nature of how supply and demand is being met in the WEM. It is therefore a necessity to review the cost allocation methodology. To not do so would be a gross oversight of governance by the PUO.

Issues

Issue 1 – Increasing WEM Administration Costs

As highlighted in Figure 12 of the AEMO submission, the cost to administer the WEM is becoming significant. When considered that under current allocation methodology the market fee is paid on both the generated and consumed MWh, the WEM fees by the end of the AR6 period will be \$2.46/MWh³. Considering the makeup of the WEM, which is a net settled and heavily bilaterally contracted market, the benefit gained from creating and maintaining such a complex system at this cost is especially difficult to justify.

The AEMO present reasoning as to why market fees have increased since market start, highlighting the “number of market customers has doubled, the number of market generators has tripled, and the overall number of facilities has increased by 60%”⁴. It could be argued however that while these numbers indicate an increasing market in isolation, the fundamental structure of the market has not changed much since market start. The WEM is still a small market compared with most other electricity markets around the world. It has an average minimum demand of around 1,500MW and an average maximum demand around 2,500MW. Generation has decreased in the time since market start as indicated by AEMO Table 14. Demand is likely to remain flat for the next five years⁵. And it is not a complex market. It has two main fuel sources and over 90% of energy is traded bilaterally. Over the last 12 month period, some rough statistics are:

- 80% of energy was produced by 14 facilities, of which 5 facilities (16% of energy produced) were must run co-gen units;
- Of the remaining energy, 10% was produced by must-run non-scheduled generation;
- 72% of energy was produced by only 10 facilities;
- 90% of energy produced is controlled by 3 operators⁶.

The point is that the market is not sufficiently complicated to adopt the types of complex designs and systems used in other much larger markets, such as the NEM, PJM, ERCOT or CAISO. Those

³ Table 15 - \$1.231/MWh multiplied by 2

⁴ Pg 42

⁵ AEMO forecasts a slight demand increase while Western Power forecasts a slight demand decrease.

⁶ Synergy, Alinta and Bluewaters/NewGen Kwinana.



markets have tens of thousands of MW's of demand, interconnection between multiple regions (and often other markets) and many more competitors and facilities. Yet the proposed market reform seems to be aimed at adding ever increasing complexity to the market. And with that, comes increasing costs.

MR 2.22A.11(c) states that "where possible, the Economic Regulation Authority should benchmark the Allowable Revenue and Forecast Capital Expenditure against the costs of providing similar services in other jurisdictions". It is noted that the market fee per unit of electricity consumption in the WEM for the AR5 period average is \$2.05/MWh. This rate is high when benchmarked against the average expectation in the NEM for the same period of \$0.56/MWh⁷.

The upward trajectory of market fees increases the appeal of a simple market structure. Considering the technical challenges System Management will face in maintaining a secure system in the coming years, maintaining a complex market will get in the way of operating the system securely, whereby the market will ultimately be circumvented more often by System Management to maintain reliability.

Issue 2 – Diminishing System Load and the Effect on Revenue

As WEM demand stagnates over the coming decade (aided by the increased adoption of behind-the-meter solar and storage), but the cost to operate the market continue to rise, market fees (those costs divided by the demand) will rise at an ever greater pace, further questioning when the cost becomes too much and the appropriateness of the existing allocation methodology.

Issue 3 – AEMO Digital Roadmap

At \$12.7m capital cost to the WEM, the AEMO Digital Roadmap represents a significant cost in the proposed capex requirement. The benefits outlined are vague in description and as acknowledged by AEMO, assessment of potential benefits was focused on the NEM. AEMO indicate that the WEM Reform program may leverage benefits from the Digital Roadmap however no such benefits are allowed for in the proposal due to the early stage of planning. NewGen Kwinana request the ERA to consider the merit of this spend along with the appropriateness of the allocation to the WEM.

Should you have any questions regarding this submission please contact Daniel Kurz on [REDACTED] or [REDACTED].

Yours sincerely

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⁷ http://www.aemo.com.au/-/media/Files/Electricity/NEM/Participant_Information/Fees/2018/Final-AEMO-Electricity-Final-Budget-and-Fees-2018-19.pdf