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23 July 2010

Discussion Paper: Annual WEM Report to Minister
Economic Regulation Authority
PO Box 8469
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Via email: publicsubmissions@erawa.com.au

Dear Sir/Madam

DISCUSSION PAPER: ANNUAL WHOLESALE ELECTRICITY MARKET REPORT TO THE MINISTER – 25 JUNE 2010

Verve Energy welcomes the opportunity to comment on the Economic Regulation Authority's discussion paper on the 'Annual Wholesale Electricity Market Report to the Minister for Energy – 25 June 2010'. Comments are detailed in the following pages.

Verve Energy would be pleased to discuss its comments with the Economic Regulation Authority should clarity be required.

Yours sincerely

WENDY NG
STRATEGY AND REGULATION
VERVE ENERGY

1. **The following comments relate to Section 3.1 titled *"Strategic Consideration for Market Design Review"***

Current Reviews

Whilst there are many reviews currently underway, the progression of these is disappointing. The prolonged decisions on the way forward are amplifying the uncertainties that exist under Federal policies such as the Carbon Pollution Reduction Scheme (CPRS). Quick decisions on these WEM reviews will provide more certainty to the Market and assist in the common goal of the efficient operation of the Wholesale Energy Market (WEM).

Verve Energy welcomes the Strategic Energy Initiatives (SEI) being developed by the OOE. This will be an important guide for setting policy views and a road map for the future for Western Australia's energy industry.

Cost/Benefit Analysis

In relation to the market design review, a goal exists to improve the effectiveness of the WEM. Verve Energy strongly agrees with the Economic Regulation Authority (**"Authority"**) that any changes to the market should be carefully analysed to ensure the benefits exceeds the costs.

Market Power

The comments below refer to the term "market power" used under the heading "*3.1 Strategic Considerations for Market Design Review*".

Verve Energy shares the Authority's concerns in relation to paying attention to market power issues whilst making market design changes. Verve Energy will continue to contribute to the development of this goal as the design evolves. A good starting point could be to examine the relevant provisions in the current market design.

- The current market design, through the Net STEM (clause 4.26.2) provisions, imposes a cost on withholding capacity. This applies to all generators except Intermittent Generators.

- In the current market design, Verve Energy argues that despite its size, it does not have market power. As the balancing generator for the system and with MCAP determined from Aggregate Portfolio Supply Curves, Verve Energy can only protect itself from selling below or buying above its cost of generation in balancing through a cost reflective Portfolio Supply Curve.

- Indeed, being required to be the balancing generator and with the Aggregate Portfolio Supply Curve used for the determination of MCAP, Verve Energy is exposed to balancing transaction losses when there

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are non-Verve Energy price-quantity steps in the MCAP region of the Aggregated Portfolio Supply Curve.

- STEM clearing prices are set jointly by all Market Participants. As Verve Energy prices its large portfolio at cost reflective levels, other Market Generators will have little success in pricing their Portfolio Supply Curves away from their costs.

- Each Market Generator will have a different cost circumstance. Some generators will have obligations outside the electricity market; others will have fuel contract limitations. Further with fuel not priced on a half hourly basis clause 6.6.3 of the Market Rules could be unhelpful. Particularly when, in Verve Energy's opinion, while Market Generators might be mispricing, there is no intentional abuse of whatever market power that they may or may not have.

- There are inefficiencies that the MRDT might want to consider as well or the Authority could encourage the market to remove:
    - Ambiguity in clause 6.7.4 when it comes to a Market Generator – Market Customer. This ambiguity could allow a gentailer to overstate its demand and not be caught as its Net Contract Position is likely to be well below its consumption
    - Improper engineering parameters such as Minimum Stable Generation
    - Unjustified Standing Data balancing prices particularly in relation to Intermittent Generators
    - Various Intermittent Generator provisions – considered separately in the Authority discussion

2. The Authority invites comment on the impact of feed-in tariff and renewable energy rebate/buyback schemes, as they relate to the efficiency, reliability and security Objectives of the Wholesale Energy Market.

These schemes contribute to the achievement of MRET targets by encouraging investment in small scale renewable energy systems, in particular PV systems. Besides the economic efficiency issues further research is required on the behaviour and effects of this type of intermittent generation and the impacts on the WEM before the schemes are expanded beyond the current level.

3. The Authority invites comment on the Reserve Capacity Credit allocation to Intermittent Generators

Verve Energy acknowledges the work currently undertaken by the Independent Market Operator Market Advisory Committee's Renewable Energy Generation Working Group (REGWG). One of the key issues that the REGWG was tasked to make recommendation on is an appropriate

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methodology to assign Reserve Capacity Credits to Intermittent Generators. At present, the absence of this methodology is risking an over allocation of capacity credits leading to higher generation cost arising from higher utilisation of open cycle gas turbines for load following. An early solution is highly favoured.

4. The Authority invites comment on the existing and potential impact of intermittent generation on the Wholesale Electricity Market, including the need for cost reflectivity under the existing framework and Market Rules.

The REGWG was established in 2008 to investigate the impacts of intermittent generation, allocation of Reserve Capacity Credits and the impact on demand for ancillary services. Whilst Verve Energy supports the uptake of renewable energy, the work undertaken by the REGWG is critical to the efficient, reliable and stable operation of the network and market. Verve Energy would like to see the benefits of the work undertaken by the REGWG coming to an early conclusion and implemented

Since the introduction of MRET, there has been a rapid increase in the investment of intermittent wind generation, in particular in the WEM. Good fuel sources and Reserve Capacity Payments offered in the WEM make WA an attractive location to invest in this type of generation. There is a strong indication that this will continue into the future with requests for a reported 3 GW of wind capacity in Western Power's queue for access.

As the volume of intermittent generation increases, the potential impacts that threaten the security and reliability of the SWIS and increase Market costs include:

- System security issues overnight
- Increase cost and less efficient dispatch of generation
- Additional ancillary services (frequency control and spinning reserve)
- Increase in system margin and balancing

These issues have been highlighted in many reviews and also in last year's 2009 Wholesale Energy Market Discussion Paper.

Whilst there is no conclusion as yet to the work undertaken by the REGWG, Verve Energy agrees with a causer pays principle.

As Verve Energy is the sole provider of balancing services, the increase in intermittent generation requires increased amounts of balancing which will impose further costs on Verve Energy.

To this effect, it is important that the correct price signals are sent to the market to encourage the efficient operation of the market.

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5. **The Authority invites comment on the current framework for network access and the determination of capital contributions for augmentation to the shared transmission network provided by Western Power. In particular:**

   - **The impact that the current framework has on the effectiveness of the Wholesale Energy Market;**
   - **The impact on investment decisions, given the level of transparency and predictability in the current network access and connection charging regime; and**
   - **The appropriate methodology for recovering transmission augmentation costs triggered by new generation in the South West interconnected system**

Network is an integral part of the electricity system. How it is operated, how and when it is expanded is critical to economic efficiency in electricity supply. The WEM has to operate on the network infrastructure and will be reliant on the network for achieving greater efficiency. This will be evidenced through how generators are added to the system, in terms of location and timing, and in terms of how loads are met.

There have been discussions around constrained and unconstrained network options. The decision on which framework should be employed in the SWIS, may require modifications to the current market design and operations of the WEM. Therefore, whether the network should be constrained or unconstrained should be decided and used as an input into market design options currently being considered, not as a parallel study. The delay in determining the appropriate framework for the WEM is affecting the rate at which the Market can mature.

Verve Energy agrees that deep connection costs are an issue. Generators should not fully bare the cost of deep connections. There is a need for reviewing the equity issue of the current approach and how economic efficiency could be achieved in operating the network as a single entity providing access to multiple generators and loads.