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Dear Mr Martin

RESPONSE TO CONSULTATION PAPER - IMPROVING ACCESS TO THE WESTERN POWER NETWORK

Bluewaters welcomes the opportunity to provide comments on the paper entitled “Improving access to the Western Power network” (First Consultation Paper). This paper was published by the Public Utilities Office (PUO) on 16 February 2018.

Bluewaters notes that this First Consultation Paper is one of the three¹ papers published by the PUO for stakeholders’ consultations in regards to issues relating to the proposed constrained network arrangement in the Wholesale Electricity Market (WEM).

This First Consultation Paper deals with, among others: (a) managing firm network access rights and (b) transitional assistance for “some incumbent generators that have made investments on the basis of the existing policy and regulatory framework”. This includes the compensation mechanism for holders of firm transmission network access rights; and (c) the essential reforms to adopt a framework of constrained network access.

Executive Summary

Bluewaters notes that the PUO has adopted a fully constrained policy position in regards to firm network access rights. Bluewaters considers this may not necessarily lead to optimal economic efficiency in the WEM. Given that detailed information on the extent of existing network constraints is not publically available, it has not been illustrated how significant the problem being addressed is.

With consideration to the significant regulatory change and complexities that are being contemplated in the papers, it has not been demonstrated that the network problems cannot be resolved by a partially constrained network model. Bluewaters notes that the modelling exercise outlined in the third consultation paper will compare a fully constrained and partially constrained network outcome and recommends that this modelling should be a key consideration in the direction taken to avoid complex wholesale changes for what may be shown as a smaller localised issue.

Bluewaters also considers the transitional assistance mechanism as contemplated in the First Consultation Paper may not lead to adequate level of compensation for parties who lose their firm network access rights.

Bluewaters also recommends that clarification be provided as to how the proposed constrained network access arrangement interacts with Western Power’s transmission network asset investment decision.

Managing firm network access rights

Grandfathering option

Bluewaters notes the PUO’s advice in the First Consultation Paper that “no generator will be afforded firm access to the network under any circumstances”. Bluewaters further notes PUO’s advice in the paper that firm network access rights “will not be grandfathered”. This means all current firm network access right holders are expected to lose this right.

¹ As of 26 March 2018.

Bluewaters considers this may not lead to an efficient economic outcome and therefore recommends that the PUO review its position on this matter.

While grandfathering generally compromises economic efficiency, there may be exceptions. Bluewaters considers the current circumstance in the WEM may give rise to a strong ground for warranting an exception.

The WEM transmission network configuration is characterised by constraints in certain parts of the network, but ample transmission network capacities in others. It is therefore anticipated that some generators connected to the network will remain unaffected by the constrained network access arrangement. Bluewaters expects that this will become clear once the modelling under the third consultation paper is complete.

Bluewaters considers dealing with compensation for the firm network access right holder can be complex and controversial. There may also be a range of interpretations as to what the adequate compensation arrangement is. One of these interpretations is such that a party who has its firm network access right removed² is entitled for compensation regardless of whether its generation is actually affected by the constrained network access arrangement. This is especially the case for generators who have contributed to the capital cost of securing such firm access.

Bluewaters considers, if a generator's generation is expected to be remain unaffected under a constrained network access arrangement, removing its firm network access right will not change its generation behaviour for promoting economic efficiency in the WEM. If such generator is entitled for compensation for loss of firm network access right (as discussed above), Bluewaters considers any such compensation will play no part in achieving the intended purpose of implementing the constrained network access arrangement.

Bluewaters considers the risk can be avoided by selectively grandfathering the firm network access rights of generators if their generation outputs are not expected to be affected by the constrained network access arrangement. Otherwise:

- If this compensation is to be funded by Market Participants, such misallocation of capital is expected to result in sub-optimal economic outcome in the WEM.
- If this compensation is to be funded by the tax payers, it would be an inefficient use of the government's tax revenue.

Impact of the proposed constrained network access arrangement on bilateral trading arrangement (Question 5(c))

Bluewaters considers the proposed constrained network access arrangement may have impacts on bilateral trading arrangements in the WEM.

A Market Participant is assigned Capacity Credits under Market Rules (MR) 4.20.5A. These assigned Capacity Credits may be "traded bilaterally" under MR 4.14.2.

Under the current arrangement, there is no risk that any certified capacity will not be assigned Capacity Credit (risk due to constraints in the transmission network). Hence, Market Participants would have entered into such bilateral trading without having to take such risk into account. For example, a generator would not have to reduce the number of Capacity Credits to be bilaterally traded - to account for the possibility that its Capacity Credit entitlements may be reduced due to network constraint.

This is expected to change under the constrained network arrangement. Under this arrangement, some of the generators may find themselves being assigned less Capacity Credits compared to what they are otherwise entitled to under the current arrangement – and therefore may not have sufficient Capacity Credits to meet their bilateral trading obligations.³

² Removed due to the constrained network access arrangement.

³ Note that a bilateral trade can be a long-term arrangement with a long lead time. Hence a generator's Capacity Credit entitlement may not be known at the time the arrangement was entered into.

Design of the transitional assistance mechanism

Bluewaters is of the view that the proposed transitional assistance mechanism as contemplated in the First Consultation Paper may not provide adequate compensation to generators who have lost their firm network access rights. This is discussed further below.

Factors influencing the design of a mechanism to provide transitional assistance (Question 6)

In section 2.5.1 of the First Consultation Paper, the PUO has identified the following considerations that influence the selection of a mechanism to provide transitional assistance:

- Generator financial losses can be identified and directly attributed to the introduction of constrained access.
- Generator financial losses can be quantified reasonably accurately, using an open and transparent process.
- Administrative costs are kept to a minimum and the mechanism is simple to implement and operate.

Bluewaters considers an additional consideration that needs to be taken into account in designing the mechanism is the compensation amount a generator (who lose its firm network access right) may be legally entitled to.

Financial losses that should be considered for the design of the transitional assistance mechanism (Question 7)

Section 2.5.2 considers that the following types of losses can be attributed to constrained access (for designing the transitional assistance):

- Wholesale market revenue loss as a direct impact of being constrained-off with the resulting outcome of settlement being less financially attractive.
- Large scale renewable energy Generation Certificate (LGC) revenue loss when an eligible renewable generator is curtailed.
- Capital contributions made by generators towards the shared network.
- Impact on Take or Pay fuel contracts

This section further notes that “[a] reduction in capacity credit payments is also likely if network constraints limit export ability under peak demand conditions.” However, the First Consultation Paper does not explicitly advise that loss of such payment is compensable under the proposed transitional assistance mechanism.

Bluewaters considers such loss is directly related to loss of the firm network access right and recommends that it be include as part of the design of the mechanism.

Options to be utilised to provide transitional assistance (Questions 8 & 9)

Section 2.5.4 of the First Consultation Paper advises that the PUO prefers a market-based solution (compared to an administrative solution) for designing the transitional assistance mechanism.

Bluewaters considers a market-based solution is possible for the losses suffered in the WEM energy market. As the Reserve Capacity market is a look-forward market, an administrative solution may be required to quantify losses under this market.

Treatment of capital contribution to augment the shared transmission network (Question 10)

If the capital contribution was made to secure a firm network access right, and if the firm right is removed from the contributor, the capital contribution (allowing for depreciation) should naturally be refundable to the contributor.

Bluewaters considers any costs associated with a reform initiative should be borne by the party benefiting from such reform.

Bluewaters considers any market efficiency benefit would ultimately be passed on to the end consumers. Therefore, it is logical that the cost associated with achieving this benefit be also borne by the end consumers. The capital contribution to be refunded is an example of the reform costs.

Essential reforms to adopt a framework of constrained network access

Are there other reforms that are essential to implement a constrained network access regime? (Question 1)

Bluewaters considers an aspect of a constrained network access regime is providing locational signal for investment of generation facilities. That is, encouraging such facilities to be built in areas with more (rather than less) access to transmission network capacity.

Bluewaters considers Western Power's investment decision of transmission network assets can alter the investment signal. It is not clear as to how the investment decision rules interact with the proposed constrained network access arrangement for delivering an effective locational signal. Bluewaters recommends that such rules be clarified as part of this reform program.

Should you have any questions regarding this submission please contact Daniel Kurz on 08 9261 2881 or daniel.kurz@bluewatersps.com.au.

Yours sincerely

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