Independent Market Operator

Wholesale Electricity Market
Rule Change Proposal Submission Form

RC_2011_10 Competitive Balancing and Load Following Market

Submitted by

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Date submitted:	7 November 2011

Submission

1. Please provide your views on the proposal, including any objections or suggested revisions.

Verve Energy confirms that it fully supports the introduction of a competitive balancing market and, subject to satisfactory resolution of the issues raised in this submission, the associated amending rules. That support has been consistently advanced as the proposed changes were canvassed through the Oates Review process and Market Evolution Program development. The expected enhancement in the efficiency of service provision together with the advent of a more cost-reflective balancing price is welcomed.

As a party that is significantly impacted by the proposed market changes, Verve Energy has actively participated in the development of the proposed amending rules through its review of the various drafts established by the Rules Development Implementation Working Group process. Many of the issues raised through that process have been satisfactorily resolved. Accordingly, the focus of this submission is on those matters that either remain unresolved or have been resolved in a manner that is of concern.

Market Power Mitigation – Verve Energy has read with interest the Market Reform report entitled 'Market Power Implications of the Planned Balancing and Load Following Ancillary service Market Arrangements' dated 30 September 2011. In that report there appear the following statements: *"... it seems unlikely that a market participant could freely exercise market power to the extent of significantly harming competition."*; *"The major finding of this analysis was that the potential to exercise market power in balancing is limited*"; and *"...the contractual and STEM positions of Verve (and other IPPs) combined with the small and* *uncertain volumes traded in balancing will substantially limit the potential for market power abuse in the balancing market".*

Yet, it has been concluded that Verve Energy specifically has market power that needs to be fettered and various measures are proposed to achieve this. These include restricting Verve Energy's balancing portfolio rebidding arrangements, limiting the flexibility of its portfolio by placing a hard limit on the number of price quantity pairs that can be submitted, and a Short Run Marginal Cost ('**SRMC**') bidding requirement. These issues, together with other relevant matters, are canvassed in more detail below. The disconnect between the apparent lack of need and the proposed imposition of these measures is noteworthy. More importantly, it is likely that the imposition of those measures, arguably unnecessarily, will lead to a less efficient market outcome than could otherwise be achieved.

- Portfolio Rebidding – Verve Energy has raised the issue of disparate bidding arrangements for Verve Energy compared to other participants many times with minimal success and only some additional flexibility gained. Fundamentally Verve Energy considers that its bidding arrangements should be the same as other participants and the argument supporting that position is re-presented here:

  "One of the outcomes of the Oates Review was the desire to facilitate the participation of IPPs in the provision of balancing services. The consensus, after some deliberation, was that this participation could be satisfactorily accomplished within the hybrid market design, with Verve Energy remaining the default provider. I do not recall it being expressed at the time that Verve Energy was gaining some advantage from this outcome.

  In that context, there appears to be no justification for the proposition that Verve Energy needs to be fettered in its use of its portfolio to compete for the provision of balancing services. Indeed, I am yet to witness a plausible reason why that should be the case. On the surface, it may appear to some that Verve Energy, in a balancing context, is afforded protection by its portfolio and enjoys the benefit of an associated flexibility and therefore needs to be restricted. However that view overlooks the inter-temporal nature of portfolio dispatch in which, amongst a range of things, minimum run time, minimum shutdown duration constraints and plant decommitment issues, for example, result in significant changes in optimum plant dispatch for relatively small changes in load or load shape. Responding to changing load forecast is not simply a matter of moving up or down the balancing portfolio supply curve.

  If the desire is, as it should be, for balancing prices to be as cost-reflective as possible and, given that Verve Energy is likely to often be the balancing price setter, it follows that Verve Energy's balancing portfolio supply curve should be updated as close to real time as practical. Indeed, if the desire is to encourage true competition within the limitations of the hybrid design, it is hard to argue against all participants being able to rebid balancing bids and offers in a similar way."

- Price Quantity Pair Limit – We had assumed that the intent of competitive balancing was not only to enable greater participation in the provision of the service but also to facilitate more cost-reflective pricing. The latter would be enhanced by seeking to ensure as much granularity in bids as possible. Placing a hard limit of thirty five price quantity pairs for Verve Energy's balancing portfolio will potentially limit the achievement of that objective. Further, the setting of the limit based on Verve Energy's recent STEM behaviour is, in Verve Energy's view, flawed. The proposed balancing market is a new market and previous STEM behaviour may be completely irrelevant. More importantly, we consider that any limit should be in the same flexible format that applies for the STEM rather than a hard limit. A hard limit may become unworkable in the event of, for example, an increase in portfolio size or a need for greater granularity. Only a formulaic determination of the number of allowable price quantity pairs would be appropriate in that situation. The current STEM limit that applies allows significantly more price quantity pairs than are currently utilised and therefore clearly provides appropriate flexibility to accommodate changing circumstances. Verve Energy considers that provision of similar flexibility is even more important in the proposed balancing market.

- Verve Stand Alone Facilities – One of the reasons given by IMO for applying a hard limit on the number of price quantity pairs available to Verve Energy for its balancing portfolio is to encourage Verve Energy to shift facilities out of its portfolio and to bid them individually. The hybrid market design, with Verve Energy maintaining a portfolio, was retained for a number of reasons not the least being system security considerations and that the benefits that may have been accrued from the alternative design did not outweigh the cost and complexity of its implementation. While the provision of the ability to remove facilities is appropriate and the lack of compulsion a sensible outcome, Verve Energy will apply due consideration to the consequences of such action before proceeding. WEM development is but one aspect of the broader electricity supply picture. Overly zealous encouragement of Verve Energy to diminish its portfolio may be detrimental to electricity supply security. IMO is urged to ensure that its market development aspirations are cognisant of, and commensurate with, appropriate consideration of that matter.

- SRMC Requirement – The requirement to bid at SRMC where it relates to market power currently exists in the STEM and has been carried over to the proposed balancing market. Although the issue of what constitutes market power and who has it is ill-defined, it is presumed that IMO considers that the SRMC requirement applies to Verve Energy as it has determined, by applying the specific measures mentioned above, that Verve Energy has market power. What is less clear is to what extent the requirement will apply to other participants. That it would apply to any participant deemed to have market power goes without saying. In response to a concern Verve Energy raised with IMO with respect to a participant taking advantage of another participant's forced outage by rebidding at non-cost-reflective levels, IMO responded that that participant would be deemed, in that circumstance, to be wielding market power. It would be useful for IMO to specifically confirm that understanding in the Rule Change report so that all participants are cognisant of the IMO's position on this matter.

Integration of the LFAS and balancing Markets – Verve Energy has long considered that care should be taken to ensure that the complexity associated with integrating the LFAS and Balancing Markets does not delay or diminish the advent of the balancing component and the immediate benefits that the market will accrue. This is particularly so given the likelihood that participation initially in the provision of LFAS is likely to be low. Verve Energy's position remains that the balancing component should be introduced first with LFAS market introduction delayed until the balancing market is well established. This would significantly reduce the complexity and cost faced by System Management and would reduce the risk of a delayed or ineffective commencement of the balancing market due to System Management IT issues.

LFAS and Balancing Bid Timing – Verve Energy is required to submit LFAS and Portfolio Balancing bids at the same time. This is problematic because Verve Energy will be required to assume that it wins all of the LFAS provision when formulating its balancing bid but, should that not be the case, will not have the opportunity to adjust the balancing bid to reflect the different LFAS outcome. Verve Energy's balancing bids should always be determined cognisant of the amount of LFAS it will be providing. Accordingly the window for Verve Energy's portfolio Balancing bid shoud be, say, one hour after the LFAS market outcome is determined and published. Retaining the arrangement proposed in the Amending Rules will disadvantage Verve Energy and almost certainly result in balancing prices that are not cost-reflective.

Requirement to Advise LFAS Providing Plant (Rule 7A.2.9(b)ii and 7A.2.9(c)ii) - Proposed clauses 7A.2.9(b) and (c) require Verve Energy to identify the Facilities assumed to be providing LFAS and the other Ancillary Services. Verve Energy uses a proprietary dispatch modelling tool to determine the basic dispatch on which prices are formed. That tool co-optimises dispatch so that there are likely to be multiple units providing the ancillary services: LFAS, Spinning Reserve (generator trip), Load Rejection, Dispatch Support and System Restart giving rise to:

- a unit could be providing multiple types of Ancillary Services;
- an Ancillary Service could be provided from several units; and
- a unit providing an Ancillary Service could provide the service from certain range of its capacity.

In real time, of course System Management will be free to choose from which of Verve Energy's portfolio plants to procure Ancillary Services that Verve Energy has 'won' and that plant could be different to what was expected when prices were developed. Further, over a single Trading Interval the capacities and the units providing the Ancillary Services could change - more dynamic than the half hourly reckoning time division that the market is designed on.

Verve Energy is currently meeting with the dispatch tool proprietor to determine to what extent the tool can be enhanced to satisfy the IMO's requirements. We will certainly want to discuss the outcome of that process with IMO. It may be more appropriate for Verve Energy to list the plant that is capable of, and likely to be, delivering Ancillary Services.

It is presumed that the intent of the requirement is to ensure that Verve Energy is not inflating its balancing prices by 'allocating' Ancillary Services to 'inappropriate' plant. Verve Energy will be very happy to work with IMO to arrive at an appropriate arrangement that will give IMO comfort that that is not happening.

Constrained On and Constrained Off Facility Balancing Quantities – The process for conversion of LFAS enablement to MWh via Rules 6.17.3 (e) and 6.17.4 (e) is unclear and may lead to an erroneous outcome. IMO is urged to consider the intent and application of these Rules.

Chapter 10 Changes – In principle, Verve Energy supports the intent of the proposed changes – that is to provide greater transparency and provision of data that will better inform participants. That sentiment is tempered by two requirements however:

- the information provision should be equitable with all participants treated equally; and
- as suggested in the Market Power report discussed earlier, publication of "*more or improved information*" is encouraged "*except to the extent that the release of such information is found to be detrimental to competition or the commercial interests of participants*"

Verve Energy reconfirms its support for the development of a competitive balancing market but urges the IMO to further contemplate whether the measures that it is imposing on Verve Energy are necessary in relation to not only the appropriate development of the WEM but also in the best interests of Western Australian electricity supply.

2. Please provide an assessment whether the change will better facilitate the achievement of the Market Objectives.

3. Please indicate if the proposed change will have any implications for your organisation (for example changes to your IT or business systems) and any costs involved in implementing these changes.

4. Please indicate the time required for your organisation to implement the change, should it be accepted as proposed.