Wholesale Electricity Market Rule Change Proposal Submission

RC_2017_06
Reduction of the prudential exposure in the Reserve Capacity Mechanism

Submitted by

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Submissions on Rule Change Proposals can be sent by:

Email to: rcp.secretariat@rcpwa.com.au

Post to: Rule Change Panel
Attn: Executive Officer
C/o Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

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

Response to RC_2017_06 and the Alternative Proposal

Perth Energy thanks the Rule Change Panel as Perth Energy has been asking for more detailed information pertaining to the risk of the issue underpinning this rule change and its associated costs of implementation.

After review, Perth Energy objects to proceeding with RC_2017_06. Perth Energy also objects to the alternative proposal put forth by the Rule Change Panel.

The basis of Perth Energy's objection for RC_2017_06 is the cost benefit identified in the call for further submissions is not justified. A payback period of less than 4 years is vague at best, and assuming this investment is paid back between years 3-4 (Feb 2022 at the earliest) this is a timeframe that is too long. Considering the Reserve Capacity mechanism is one of the major reform items for the state government, Perth Energy has no comfort the 'solution' put forth in this call for further submissions will remain relevant, or will not need further amendment before the investment can be paid off.

The basis for the objection for the alternative proposal is that places an unnecessary prudential burden on market participants. Discussions throughout the development of RC_2017_06 have provided several avenues as to which AEMO can lower their exposure to market participants and therefore lower the onerous prudential requirements. These have all been ignored for the development of the alternative proposal, and as such Perth Energy objects to the alternative proposal as it feels in the absence of RC_2017_06 the alternative proposal is in contravention to market objective 1.2.1 (b).

Perth Energy's ideal solution

As per initial feedback put to AEMO on the 10th of March 2017[1]:

"Perth Energy would prefer AEMO to take a holistic approach to this issue, and to focus on implementing the more fundamental changes required in the settlement system such as weekly settlements and daily IRCR"

Taking the time to improve the settlement system in its entirety by reducing the time lag associated with the settlement timeline for both energy and reserve capacity obligations will provide material long lasting benefits to the market. The current rule change proposal and alternative scenario are simply temporary improvements that aim to paste over the fundamental issues surrounding the AEMO settlement system.

As it stands most retailers can provide a bill to their customers within a few days of the end of the relevant billing period; however AEMO take approximately 45 days after the end of the billing period to settle their liabilities with market participants. This is a clear deficiency within AEMO, and improving the settlement timeline to either weekly settlement or settle monthly amounts closer to the end of the billing period would yield material benefits to the market.

[1] This feedback was provided via email in response to an information session prior to the rule change being submitted to the Rule Change Panel

Summary

Perth Energy is of the view that managing capacity market prudential exposure should act as a catalyst to improve market settlements and the aim should be minimizing the extent to which the market operator is holding the funds of market participants. Rule Change RC-2017_06 scratches the surface of this objective, but given the high cost to implement, Perth Energy believes the result for the market is substandard. Even though Perth Energy views RC_2017_06 as sub-optimal, the alternative proposal is worse and appears that it will act to impede competitiveness and efficiency within the SWIS.

Perth Energy would recommend AEMO and the Rule Change Panel take this opportunity to manage the issue regarding prudential exposure by reviewing the WEM settlement process holistically with a view to providing market participants a 'fit for purpose' solution that will result in lowering of barriers to entry into the WEM over the medium to longer term.

Rule Change Panel Specific Questions

What impact do AEMO's updated cost estimate and the cost benefit analysis have on your views of RC_2017_06?

The publication of cost estimates is extremely useful in Perth Energy arriving at an informed opinion on the merits of this rule change. The updated cost estimate is useful, however the redactions of key variables in the payback period such as the Total cost to implement (TCI) and the cost of additional credit support (CCS), make the cost estimate appear unrealistic.

Perth Energy would question the validity of an implementation cost of $2.7m. The major changes proposed are a shifting of the reference month from 'n-3' to 'n' and a change to the capacity credit allocation timeframes in which generators and retailers can allocate capacity credits. From Perth Energy's understanding no new systems are required to achieve this, just adjustments to existing systems. It is difficult to understand from the data provided how this could cost $2.7m.

The long payback period timeframe has also driven Perth Energy's objection, as it is not clear this investment will ever be paid back, as it may become redundant through market reform. Providing comfort that market reform or regulatory changes will not make this investment in changing the IRCR and capacity credit allocation rules a bad investment prior to the payback period being reached would be helpful.

It is also unclear if the payback period includes the 12 months Synergy may require in order to renegotiate their PPA agreements that are affected by the rule change. As such the payback from this investment could exceed 4 years from the date of ministerial approval.

Do you agree with the Panels approach to the cost benefit analysis of RC_2017_06? If not, please provide reasons and propose an alternative approach

A cost-benefit approach is useful, however it cannot be the sole decision making criteria. Allowing qualitative benefits and issues to be present in the decision making process regarding rule changes is imperative for considered decisions to be made. Whilst a cost-benefit approach is useful in understanding how a market rule change achieves objective 1.2.1 (a) and (d) of the Market Rules, it does not provide any clarity on how a market rule change will achieve objectives 1.2.1 (b), (c) and (e).

With regards to RC_2017_06 specifically, it is hard to assess the validity of the cost-benefit approach applied, when the majority of the variables have not been made publically available *for comment.*

Perth Energy questions the 'benchmarking' of the cost-benefit analysis against the alternative case, as it is not clear what reasonable alternatives are available in the absence of accepting rule change RC_2017_06. Benchmarking against a 'no-change' case for both RC_2017_06 and the alternative case, will provide greater insight on what kind of costs and benefits the market can expect to see based on the information provided to date.

<u>What is your per dollar cost of providing credit support?</u>

Perth Energy agrees with the Rule Change Panel in stating that the cost of credit support is the opportunity cost of not entering into investments, as credit support amounts held by AEMO inhibit new investment from taking place. Under this view, credit support to AEMO can be seen as a barrier to maximizing market objective 1.2.1 (b).

Instead of trying to value the cost of credit support, the Rule Change Panel should target the lowest possible amount of credit support required to achieve objective 1.2.1 (a), such that market participants are given maximum support in being able to undertake investments and promote competitive behavior in the SWIS and facilitate new entry of new competitors (MR 1.2.1 (b)).

<u>Given the nature of AEMO's investment in systems and your costs to implement RC_2017_06:</u>

(a) *<u>What do you consider to be a reasonable payback period?</u>*

Given that this rule change is likely to make participants 'credit support' neutral compared to the levels they hold today, Perth Energy would view the benefits of this rule change as minimal, and as such implementation should have a relatively low cost and a short payback period. A payback period within 12 months would be expected for what should be considered minor changes to AEMO's settlement system.

As the market has carried this risk since market start, Perth Energy is happy to continue to carry this risk until a fit for purpose solution can be put in place which aims to provide larger benefits and actually works towards reducing the amount of credit support held by market participants.

(b) *<u>What do you consider to be an appropriate discount rate for use in this cost-benefit analysis?</u>*

N/A