Wholesale Electricity Market Rule Change Proposal Submission

RC_2017_06
Draft Rule Change Report - Reduction of the prudential exposure in the Reserve Capacity Mechanism

Submitted by

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

Bluewaters notes that the Rule Change Proposal aims to mitigate a recently identified prudential risk without imposing a need for excessively burdensome additional Credit Support. An aspect of the Rule Change Proposal involves changing the responsible party reference month in the Individual Reserve Capacity Requirement (IRCR) calculation from "month n-3" to "month n".

An IRCR calculation uses the "meter ownership" and "meter reading" information as input variables. The Draft Rule Change Report agrees with the Rule Change Proposal's recommendation to change the reference month for meter ownership information from "month n-3" to "month n". This proposed change applies to both Existing Meters[1] and New Meters[2].

[1] An Existing Meter is a meter that existed during the Hot Season prior to the month which the IRCR incurs.
[2] A New Meter is a meter that did not exist during the Hot Season prior to the month which the IRCR incurs

This proposed change however, does not apply to the meter reading information for New Meters. That is, the Draft Rule Change Report proposes to keep the reference month for meter reading input for New Meters at "month n-3" (rather than changing it to "month n" – as in the case for the meter ownership input).

Contrary to the position in the Draft Rule Change Report, Bluewaters considers changing the meter reading reference month for New Meters to "month n" provides a more robust case for promoting economic efficiency which in turn promotes the Wholesale Market Objectives. Section 2 of this submission discusses this in further details.

The positions in regards to meter referencing for IRCR calculations are summarised in Table 1 below.

Table 1: Summary - input information of IRCR calculations

Information used for IRCR calculation	Current arrangement	Rule Change Proposal position	Draft Rule Report position	Bluewaters' position on proposed change
Meter ownership (New and Existing Meters)	Based on information in month n-3	• Based on information in month n. • This can compromise the accuracy of the input information. This is proposed to be addressed by recalculation of IRCRs in the settlement adjustment process.		Agree
Meter reading (Existing Meters)	Based on the 12 peak intervals in the last Hot Season			Agree
Meter reading (New Meters)	Based on the 4 peak intervals in month n-3			• Disagree • Bluewaters' position is "Based on the 4 peak intervals in month n" • Address IRCR uncertainty using the settlement adjustment process.

As discussed later in this submission, the proposed position to use "month n-3" for the IRCR calculation for New Meters is expected to give them "free IRCR" for three months, subsidised by the Existing Meters. This gives rise to economic inefficiency.

In the event where the Rule Change Panel (Panel) decides to maintain this proposed position in its final Rules determination, in order to address the economic inefficiency issue, Bluewaters is of the view that there should be a provision in the Market Rules to recover such "free IRCR" from the New Meters, and pay the recovered costs to the parties who subsidises these costs (i.e. the Existing Meters).

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

New Meters are expected to get "free IRCR" in their first three months of operation as a result of the combined effect of: (a) changing the meter ownership reference month to "month n" and (b) keeping the New Meter's meter reading reference month at "month n-3". These "free IRCR" means the true costs for Market Customers with New Meters are not properly reflected, and are essentially a subsidy for the Market Customers. Subsidies contribute to economic inefficiency and can result in over-investment[3] (in this case, over-investment in New Meter loads). The economic term for such inefficiency is deadweight loss. Deadweight loss[4] results in reduction of economic welfare compared to the circumstance where such subsidy does not exist.

Under the proposed arrangement, the "free IRCR" in a month is expected to be subsidised by the Existing Meters. Such subsidy is essentially a tax on the Existing Meters. Such tax also results in a deadweight loss[5] hence compromise the welfare in the economy.

Minimising the deadweight losses promotes economic efficiency which in turn is expected to promote the Wholesale Market Objectives. Bluewaters considers the Market Rules should not deviate from this fundamental economic principle unless there are compelling reasons for meeting the objectives. Examples of these compelling reasons include promoting power system reliability and security and promoting competition.[6]

Bluewaters considers the Rule Change Report has not provided such compelling reasons. This is discussed in further details in this submission.

<u>IRCR uncertainty</u>

The Draft Rule Change Report proposed to continue using "month n-3" as the meter reading reference month for New Meters. A reason for this is that using "month n" would give rise to uncertainty/inaccuracy in the calculated IRCRs.[7] In regards to this matter, Bluewaters notes the following advice from the Rule Change Report:

- "The Rule Change Panel considers that the inherent uncertainty of using month n as the meter data reference month [for New Meter] would create more problems than keeping the meter data reference month at month n-3. Therefore, the Rule Change Panel supports AEMO's proposal to keep the meter data reference month at month n-3."

The Rule Change Report further advised that:

- "The uncertainty of Market Customer's IRCR would result in uncertainty of Market Customers' Outstanding Amount and would therefore increase the prudential risk for the market." and

- "The Relevant Demand for Demand Side Programmes could not be determined [due to IRCR uncertainty/inaccuracy] adequately for dispatch. The calculation of the Relevant Demand for Demand Side Programmes is based on the IRCR of the associated loads".

[3] Over-investment means investment over and above the efficient level.
[4] Impact of subsidy on deadweight loss is a well-accepted economic principle. Explanation is available here.
[5] Impact of tax on deadweight loss is a well-accepted economic principle. Explanation is available here.
[6] Another common reason for providing subsidy (hence tolerating the economic inefficiency) is promoting fairness and equity in the economy. This reasoning should not apply under this circumstance because fairness and equity is not an element of the Wholesale Market Objectives.
[7] This is because there is a lag in meter data availability.

- "While the Rule change Panel agrees that using n-3 as the meter data reference month is not ideal, it does not consider that moving the meter data reference month to n, as proposed by Bluewaters in its submission, is viable since the Indicative IRCRs (which must be published before the start of month n and are used for customer billing, prudential monitoring, and determination of Relevant Demands for Demand Side Programmes) must be as accurate as possible."

Bluewaters notes that an overarching principle for this Rule Change Proposal is trading IRCR certainty for the ability to better manage the newly identified prudential risk exposure. Under the proposed arrangement, by using "month n" as the reference month for meter ownership input information, the certainty of calculated IRCR is expected to be compromised. The Rule Change Proposal proposed to address this uncertainty by introducing provisions to recalculate the IRCRs in the settlement adjustment process (see the first row of Table 1). This proposed arrangement was accepted by the Panel in the Draft Rule Change Report.

It is not clear to Bluewaters as to what the economic argument is for not applying the same principle for the meter reading input for the calculation of IRCR for a New Meter. That is, using the four peak interval meter reading information based on "month n" rather than "month n-3", and address the issue of IRCR uncertainty/inaccuracy using the settlement adjustment process (see the third row of Table 1). Bluewaters notes the Draft Rule Change Report's reasoning for this proposed decision. However, it is Bluewaters' view that the reasoning does not support sound economic principles. Bluewaters' responses to these reasoning are discussed later in this submission.

<u>Incentivising behaviour for promoting the Wholesale Market Objectives</u>

The Draft Rule Change Report states that "removing the time lag for the responsible party reference month but not for the meter data reference month for new meters does not incentivise any undesirable Market Customer behaviour."

Bluewaters strongly disagrees with this reasoning. As discussed earlier in this submission, the subsidy and tax arise from the proposed arrangement compromises economic efficiency and contribute potential over-investment of New Meter loads. This distortion in economic signal does not drive behaviour promoting an efficient economic outcome (hence is undesirable).

The Draft Rule Change Report also states that "[i]f anything, not charging a new meter for IRCR during the first three months of registration incentivises the installation of new interval meters which is desirable."

Bluewaters also strongly disagrees with this statement. The increased New Meter installations (as a result of the subsidy) are reflective of an economic outcome where the output is over and above the efficient level.

The Panel may consider the impact of the deadweight losses and economic signal distortion to be immaterial compared to the cost of managing the IRCR uncertainty. If this is the Panel's view, Bluewaters recommends that the Panel performs such cost-benefit analysis to support its Market Rules decision (quantitatively if possible).

<u>Market Customers and AEMO estimating IRCR for New Meters</u>

The Draft Rule Change Report also states that "it is not reasonably possible for Market Customers to estimate the IRCR or the relevant meter readings (as suggested by Bluewaters) for new meters before the actual month if the reference for meter data is moved

to month n because the IRCR is determined by the share of consumption during the 4 peak SWIS Trading Intervals."

Bluewaters is of the view that this statement should be tested and independently verified.

Bluewaters considers managing uncertainty is already an element of Market Customers' and AEMO's business operations. An example of such uncertainty is that relating to load demand. Such uncertainty is being managed by Market Customers and AEMO by developing load forecasting methodologies.

Bluewaters sees no reasons as to why IRCR uncertainty should be treated differently. Bluewaters also does not see why it would be not reasonably possible to manage such uncertainty by developing the relevant forecasting methodologies (or by other means).

Bluewaters wishes to point out that the proposed settlement adjustment process is a fail-safe mechanism to account for any inaccuracy of the IRCR forecast. Therefore, accuracy of the forecast may not be so critical that requires prohibitive costs for developing the forecasting methodology. Market Customers who value such IRCR certainty would naturally be incentivised to invest in developing a more accurate forecasting methodology – and they can be given a choice for striking a balance between cost and IRCR accuracy.

Public benefit vs private benefit

As discussed in Bluewaters' submission for the Rule Change Proposal, promoting economic efficiency (i.e. minimising the deadweight losses) is a public benefit which directly benefits the end consumers. Economic efficiency is promoted by using "month n" for the meter reading reference data for the New Meters (rather than using "month n-3").

Using "month n-3" as the reference month, on the other hand, is likely to result in subsidy to New Meters and tax on Existing Meters. The compromised economic efficiency is offset by the benefits from reduced IRCR uncertainty. The reduced IRCR uncertainty, however, is a private benefit to the Market Customers. Unlike the case for using "month n", there is no certainty that such benefit will be passed on to the end consumers for promoting the Wholesale Market Objectives.

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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.

As per Bluewaters' comments in its submission for the Rule Change Proposal.

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

As per Bluewaters' comments in its submission for the Rule Change Proposal.
