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Dr Patrick Walsh
Utilities Commissioner
Utilities Commission
GPO Box 915
Darwin NT 0801

Dear Dr Walsh

Re: Utilities Commission Review of Wholesale Electricity Generation Market

Thank you for the opportunity to respond to the Utilities Commission's Draft Report on the Review of Wholesale Electricity Generation Market (the Review).

Power and Water Corporation (PWC) sent a draft response to the Review via email on 28 January 2014 on the understanding that it would be subject to revisions based on discussions at the Board level. This has now taken place and I am able to attach a final version of Power and Water Corporation's (PWC) response to the Draft Report in table format.

The first half of the table addresses the Utilities Commission's key areas of interest highlighted in the Draft Report. The second half of the table addresses issues raised by individual business units within PWC. Two versions of the submission are provided. The first contains information which is commercial-in-confidence. This is shaded in yellow in the table and not to be made public. The second version is for public consultation.

Please contact Djuna Pollard, Senior Executive Manager, Strategy, Economics and Regulation on (08) 8985 8431 if you have any queries in relation to this response.

Yours sincerely

John Baskerville
Managing Director

February 2014

PUBLIC DOCUMENT

Utilities Commission (UC) Review of Wholesale Electricity Market Generation

Power and Water Corporation's (PWC) submission on Oakley Greenwood's draft report for consultation

Utilities Commission's nominated 'Key Areas of Interest'	Power and Water Corporation Response
<p>Proposed establishment of a Northern Territory Electricity Market (NTEM) with separate reliability assurance and energy trading mechanisms.</p>	<p>PWC considers that the establishment of a Northern Territory Electricity Market (NTEM) with separate reliability assurance and energy trading mechanisms is an appropriate response given the existing industry environment, emerging opportunities presented by Government initiatives and likely introduction of additional generators to the Northern Territory.</p> <p>However, there are a number of issues arising from Oakley Greenwood's <i>Wholesale Electricity Generation Market Review</i> (the Review) which are of concern to the different business units within PWC particularly with structural separation occurring in mid-2014. The responses below attempt to capture the concerns of each of the five individual business units impacted by these changes. They highlight those areas that require further consideration prior to finalisation of the wholesale electricity market arrangements.</p> <p>An overarching concern is that due consideration has not been given to the relative costs (and benefits) of the alternative wholesale market frameworks considered in the Review. For instance, the Review discusses the likely implementation and operational costs, but does not consider the relative magnitude of these for each different potential market framework. This includes:</p> <ul style="list-style-type: none">• The cost of transferring the regulation role to the Australian Energy Regulator as stipulated in page 34 of the Review;• The creation of new roles (which are required by the new arrangements) that will imply

	<p>additional costs and resourcing. (This is detailed in page 36 of the Review);</p> <ul style="list-style-type: none"> • Training and accreditation of staff in Generation areas, Retail areas, and the Reliability Manager. The costs may differ according to the chosen framework (page 36); and • Installation of software support. This is identified on page 31. <p>As such, it is recommended that a comparative analysis is performed so as to determine that the selected framework is the optimal one for the Northern Territory market.</p>
<p>Establishment of a Reliability Assurance Mechanism to ensure relatively stable market prices based on cost of production and a Reliability Manager (new role).</p> <p>Reliability assurance mechanism to involve:</p> <ul style="list-style-type: none"> • a central reliability assurance contracting body, possibly within an expanded System Control function, setting minimum requirements for generating and controllable demand side investment; • a regular tendering process for owners of generating and demand side capacity to submit offers to contract with the reliability body or submit notice that contracts have been entered into with customers for an equivalent amount of capacity; • term of contracts to reflect a balance between investment certainty and prevailing supply/demand balance; and 	<p>PWC considers that the establishment of a Reliability Assurance Mechanism (RAM) and hence the role of the Reliability Manager is an efficient approach for NT's power system, particularly as this role is expected to operate in conjunction with the Market Operator (see Table 1 within the Review).</p> <p>PWC recognises that this will require an expansion of the System Control function. However, System Control already has the knowledge and experience of the issues facing the NT system i.e. its small scale, the three individual regulated systems, and system participants (which outside parties would not readily possess). As such, a Reliability Manager within System Control could be reasonably accommodated.</p> <p>From a PWC Generation perspective, the major concern of the proposed RAM is that it creates a potential risk of stranded assets. In this case, capacity would be available in the real time trading process but would not receive revenue from the Reliability Manager under a RAM arrangement. The Review is unclear on how this might be mitigated.</p> <p>The Review is also silent on those arrangements that should prevail for gen-tailers. In particular, tendering processes for demand side capacity.</p> <p>Furthermore, the Review proposes that the Reliability Manager has the role of determining capital investments. Rules surrounding risk mitigation of over or under investment based on this premise, should be carefully considered.</p> <p>Notably, the Review considers the potential arrangements at a high level without going into details or possible impacts. Further issues in addition to those outlined above, are likely to be</p>

<ul style="list-style-type: none"> reliability assurance contracts to be financial in nature and impose a financial penalty on holders of a contract which are unavailable for operation when reserve is low. 	<p>raised once those details become apparent.</p>
<p>Proposed energy trading mechanism</p> <p>Design features involve:</p> <ul style="list-style-type: none"> a security constrained gross dispatch pool managed by the System Controller; dispatch to be based on availability submissions from generators with prices initially required to be no more than demonstrable short run cost (with guidelines as to how to assess cost); a marginal clearing price from real time operation; and settlement of the pool to allow for gross or net volumes at the discretion of market participants. 	<p>PWC supports the establishment of an energy trading mechanism as part of the wholesale electricity generation market.</p> <p>As noted above, System Control is best placed to take on those functions that require knowledge of NT-specific market issues. It has prior experience in monitoring and reconciliation of energy balances from when NT Power Group Pty Limited entered the market in 2001.</p> <p>However, from a PWC Generation viewpoint, section 5.5.2 presents a risk to its business. This section recommends that bid prices are limited to short run marginal cost. The intent is to encourage competition and control market power. However, the bid price restrictions mean PWC Generation will not receive sufficient revenue to cover its fixed costs. Consequently, this brings significant financial implications unless Government commits to covering this shortfall.</p> <p>Related to the point raised above, there is a degree of inconsistency in the review regarding how to set the bid price. Section 6 recommends the NTEM adopts the rules of the NEM where prices are not required to match costs. However, Section 4.4.3 states bid prices are to be capped at the demonstrable cost of production. Furthermore, Section 5.5.2 suggests a bid price restriction to short run marginal cost on PWC Generation. PWC seeks clarification and further consideration of the methodology to be adopted.</p> <p>As also noted above, much will depend upon the individual design features of the mechanism and PWC is likely to have further comments when those details are available.</p>
<p>Establishment of the Independent Market Operator function.</p>	<p>PWC supports the establishment of an independent market operator with close links to the System Controller. Contrary to the point raised on page 34 of the Review, PWC considers that this role (and also the Reliability Manager and the System Controller) should be independent of PWC Networks and is best placed within System Control. An independent market operator function is consistent with best practice in other jurisdictions, avoids a potential conflict of</p>

	interest, and allows for shared synergies within the System Control area.
Better clarification of the roles and independence of System Control.	<p>PWC is supportive of an independent System Control. This is consistent with best practice in other jurisdictions and is appropriate given their expanding responsibilities under the proposals put forward in the review.</p> <p>Of relevance here are the existing System Control charges that apply to energy usage. The current rate of 0.1 cents/kWh has remained unchanged for a considerable period of time and arguably are no longer cost reflective. In the context of this changing market, PWC considers that any new measures should also incorporate an evaluation of these charges.</p>
Development of market rules, using the National Electricity Rules (NER) as a template.	<p>PWC is mindful that while the National Electricity Rules (NER) may be reflective of best practice for the electricity market in the eastern and southern states, they are unlikely to be suitable in their entirety for the NT market. PWC considers that while the NER may be used to develop an overall template, the actual market rules should be tailored to the particular features and conditions of the NT market with input from its market participants.</p> <p>While the Review recognises that there will be costs of drafting and implementing the NER, it does not provide a cost-benefit analysis of adopting the existing rules of either the NEM or WA's WEM and the consequent adjustments to suit the NT Generation market. PWC considers that this should be a prerequisite prior to selecting a particular rule and framework design.</p>
Proposed implementation options, including possible interim arrangements and transition path.	PWC is supportive of the implementation timeline. However, more details are required regarding the design of interim arrangements and how these will impact day-to-day operations for the individual business units. This is covered in more detail in the latter half of the table which addresses individual business concerns.

Power and Water Corporation nominated Areas of Interest	Issues requiring further consideration
Implications of proposed wholesale electricity generation market arrangements given structural separation with PWC Gas Supply Unit in a different government-owned corporation from PWC Generation.	<p>The Review does not address how gas supply should be managed in the context of a wholesale electricity market with multiple generators, multiple gas suppliers and structural separation of PWC.</p> <p>PWC Generation also considers that a true level playing field would be one on which it could contract with alternative gas traders if it were commercially advantageous to do so.</p>
Accounting for line losses under the proposed arrangements	PWC requests a detailed procedure regarding line losses and their recovery outlined in section 5.8 of the Review. It is currently unclear how the reconciliation of metering data will occur and what financial transactions would exist between parties.
Suitability of proposed arrangements for smaller power systems	The Review is contradictory on the suitability of proposed arrangements for smaller systems. In the Executive Summary (page 3) it suggests that the design can be readily applied to the Alice Springs and Tennant Creek systems. However, page 12 states that a quantitative analysis will be required in order to determine if this is the case. Without such an analysis it is unclear whether customers in Alice Springs and Tennant Creek will benefit from these arrangements.
Generation Reliability Standards	Consistent with previous submissions to the UC regarding Standards of Service, PWC considers that these should be revised to consider the new wholesale market arrangements, in particular which performance measures are suitable for the NT market.
Energy trading in the market	It is unclear from the Review as to whether the recommendation is for a gross electricity market or whether bilateral contracting between parties will be permitted and therefore settlement would be on a net basis. PWC seeks clarification on this point.
Provision of metering data to third parties and processes for charging for the data	<p>The provision of metering data is necessary for generators and retailers in the market (in addition to customer requests for this information).</p> <p>The Review is unclear on the processes for provision and charging of meter data for market</p>

	participants going forward given the likelihood of multiple generators.
Education and Training for market participants	Given the substantial changes to the market, PWC considers that it would be appropriate to provide market training seminars for all market participants.
Impact of proposed wholesale electricity market arrangements on PWC Retail	<p><u>Existing Contracts with Customers and Generators</u></p> <p>The Review is unclear on how existing customer contracts should be managed given the proposed changes to the wholesale electricity market i.e. whether existing contracts will be honoured or whether there will be a direction regarding a “grace period” for those customers wishing to pursue new contracts with other retailers.</p> <p>In the event that customers were allowed a “grace period” to move to other retailers, there would be a risk to PWC Retail for its load already contracted with PWC Generation. As such, either the contracts with PWC Generation would also need revisiting or Government would need to meet a potential shortfall created by the transition to new market conditions.</p> <p>Furthermore, PWC Retail currently has non-commercial contracts (eg. Tranche 4) which are funded by CSO arrangements. PWC seeks direction on how these are to be managed going forward i.e. whether a CSO will apply to other retailers in the market.</p> <p>PWC seeks direction on how these contracting measures should be managed.</p> <p><u>Obligations in the Event of a Gen-tailer Collapse</u></p> <p>The Review does not specify PWC Retail’s obligations in the event that a gen-tailer goes into insolvency. The existing Electricity Retail Supply Code makes provision for a Retailer of Last Resort Event but is silent on this issue.</p> <p><u>Metering Costs</u></p> <p>Customers wishing to switch to an alternative retailer are currently obliged to install an interval meter. PWC seeks clarification on which parties should bear the costs of meter installation in the context of increased competition in the generation and retail markets.</p>

Pricing Orders

PWC Retail is currently required to charge the majority of customers those tariffs set by pricing orders. PWC seeks direction on whether those pricing orders will also apply to *all* retailers in the market.