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Submission to the Standing Committee on Uniform Legislation and Statutes Review on the Inquiry into the National Energy Bills 2016

National Electricity (Western Australia) Bill 2016

22 July 2016

Perth Energy would like to thank the Standing Committee (**Committee**) for the opportunity to make a submission on the *National Electricity (Western Australia) Bill 2016* (**NEWA Bill**) and the *Energy Legislation Amendment and Repeal Bill 2016* (**ELAR Bill**).

Key submissions:

1. Parliament's sovereignty should not be ceded if, as here, the resulting benefits are insufficient.
2. These complex reforms have not been adequately consulted with private industry participants and have not taken into account the sharp differences between the WA electricity market structure and that in the Eastern States. The package before the committee is incomplete, so the committee cannot assess its benefits.
3. Implementing constrained network access may be technically desirable, but it can directly impact existing companies' value and entitlements, exacerbating the significant sovereign risk associated with the government review of the electricity market which the Bills form part of.
4. The complex interplay between constrained network and the (electricity) reserve capacity mechanism review as proposed by the government requires stringent transitional mechanisms.
5. The ELAR Bill contains a statutory abolition of existing generators' contractual rights to firm network access. This can dramatically devalue existing merchant assets (i.e generation assets not owned or contracted to State owned Synergy) and deprive them of legitimate revenue streams. The Bills contain no compensation mechanism, and current indications are that there may never be one. This contravenes long-established parliamentary conventions.
6. This provision is specifically designed to benefit State-owned businesses. It does so at the risk of significant losses to private merchant investors who were attracted to the market by previous reforms that promise an open and competitive market with stable market rules. This heightened sovereign risk will deter future investors and financiers.
7. Already, major Australian banks have refused to re-finance merchant generation assets as a result of the government proposed changes to the reserve capacity mechanism. The Bills will add to the overwhelming sense of risk for private investors in the WA market, potentially forcing the funding and cost of future infrastructure investment back onto WA taxpayers with all the concommittent exposures.

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8. The committee should not approve the Bills, until they contain a suitable compensation mechanism to accompany the abolition of firm network access rights and reflect the full devaluation of merchant generation plants through the proposed changes to the reserve capacity mechanism. Once the Bills are passed, the WA Parliament loses its ability to regulate this matter. That will have been ceded to the other jurisdictions.

9. On a separate matter, before ceding jurisdiction, the Committee should require that the Bills include suitable control and review mechanisms to ensure that WA market participants are protected against the risk that Eastern-States based regulators, focussing on the Eastern-States grid and market, may not be responsive to WA market participants or understand the WA market's needs.

Perth Energy generally supports true electricity reform

Perth Energy supports electricity market reform to increase competition and encourage private sector participation as specified in the objecctives of all government reform programs to date. This is the best way to sustainably drive down electricity prices and avoid the need for further State debt to fund investment in the electricity system.

However, not all 'reforms' to date have stayed true to the express reform objectives. The Electricity Market Review (EMR) Stage 1 in 2014 was conducted by an independent panel whose report includes 14 recommendations that are consistent with the previous reform programs. But EMR Stage 2 of 2015 took up only 4 of those recommendations for implementation, with the other vitally important recommendations ignored.

Further, the taken up recommendations have been poorly implemented, with the steering committee comprised only of government agencies, including Synergy, with no representation from private merchant participants. It is this latter category of participants that WA needs and that successive WA governments have encouraged to enter the market to relieve WA taxpayers of the costs and risks of electricity infrastructure investment.

As a result, the currently proposed changes to the electricity market from EMR Stage 2 have resulted in widely perceived sovereign risk for the State, causing major Australian banks to withdraw from project financing of private sector assets, even refusing to refinance merchant assets that they had project-financed earlier.

Representation from Perth Energy, the only new entrant merchant electricity generator-retailer that has successfully grown in this market over the last 16 years, has been mostly ignored by EMR Stage 2 steering committee. The most critical changes proposed concern the workings of the reserve capacity mechanism. The changes are so radical in nature and dismissive of the losses faced by private sector merchant investments that they now represent the biggest risk to WA's standing as an investment destination.

Perth Energy has been a supporter of electricity market reform since our inception and remains strongly so. But we have grave concerns over the ELAR Bills given the interplay between what is proposed in the Bills and the proposed changes to the reserve capacity mechanism as well as absence of review or change to other critical aspects of the electricity market.

Parliament's sovereignty should not be ceded if, as here, the resulting benefits are insufficient

The NEWA Bill cedes to the SA Parliament the power to amend the National Electricity Law, and to a federal body (the AEMC) the power to amend the critical National Electricity Rules. The WA Parliament cannot make future changes to the laws, regulations or rules without all participating jurisdictions' consent.

Uniform legislation should only be adopted if the benefits to WA exceed the disadvantage of ceding WA Parliament's sovereignty to another jurisdiction.

For the reasons set out in this submission, Perth Energy submits that this is not the case with the Bills currently before the Committee.

The reforms are being rushed for no clear reasons

The Bills form part of a larger suite of immensely complex electricity reforms, which are all being rushed through to meet the government's timetable with insufficient time for consultation and consideration.

The apparent main reasons for rushing the Bills are said to be preparation for further network connection of new generation plants and Full Retail Contestability. But given the market has substantial excess baseload capacity, with the government announcing closing 380MW by October 2018, new plant connection is not an urgent matter. Only renewable energy capacity may be needed, but this category cannot enter the market in large volume due to commercial and network stability (not network capacity) constraint.

The more renewable energy capacity entry the more fast response fossil-fuelled peaking or mid-merit capacity the system requires. Otherwise, WA will soon hit the problems seen recently in South Australia, where power prices have surged due to over-reliance on wind farms without sufficient gas-diesel plant back-up.

Yet, in WA, the EMR Stage 2 outcome has been the proposed radical changes to the reserve capacity mechanism that are aimed at driving out of the market brand new, high efficiency fast response generation plant while preserving and protecting Synergy's 30-40 year old, high emission plant.

These proposed changes represent the severest sovereign risk encountered by private investors in electricity assets in the history of electricity market reform over the last 30 years.

The Bills will simply add to this significant sovereign risk.

These reforms are complex, and haste will produce errors

These Bills implement parts of the national energy regime, which comprises many hundreds of pages of law. Those laws are written as an integrated whole, but the WA government has chosen to adopt only some parts of the national regime. This makes implementation exceedingly complex.

Unfortunately, the short timetable means that the project implementation team has had insufficient time to consider and consult on these changes. The result will be flawed. This will bring more cost and disruption to energy sector participants, disadvantage the State's economy, and deter investors.

From this Committee's perspective, the main problem is that because the reform is being done by way of uniform legislation, by passing these Bills the WA Parliament will lose most of its control over how to remedy the resulting problems, because future amendments to the uniform scheme will require the consent of all participating jurisdictions, even if those amendments are specific to WA.

This is too high a risk for the State to take.

The package currently before the Committee is incomplete, Its value and impact cannot be assessed.

Because of the rushed timetable, the current package of Bills is not the complete reform package. The Committee is unable to assess whether ceding sovereignty is desirable or valuable, because it cannot see:

- the proposed accompanying changes to the National Electricity Rules and regulations which will embody most of the substantive provisions which impact on market participants' rights and revenue;
- the *National Electricity (Transitional and Consequential Provisions) Bill 2017* which the government has foreshadowed;
- the potential impact on WA's electricity market and economy as a whole.

The project implementation team has acknowledged that much of the all-important detail is still being worked out, including on critical aspects such as how constrained access will actually work in WA's unique wholesale electricity market.[1]

This committee is thus being asked to confirm whether WA should cede sovereignty in order to implement a regime, when the government itself does not yet know how that regime will look like, much less how or if it will work.

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[1] The 23 June 2016 Information Paper (see footnote 2) indicates that papers are yet to be published on: a registration system to actually apply the National Electricity Rules in Western Australia (page 18); how constrained network access will be implemented in WA's wholesale electricity market (page 35); how network quality, security and reliability will be managed (pages 37 and 38).

Constrained network access is a potentially valuable, but very complex, reform, which can directly impact existing companies' value and entitlements

(The concepts of constrained and unconstrained gird access are complex. Perth Energy would be happy to provide more information to the Committee if necessary to explain why this quite technical issue has a material financial impact on existing private investment.)

Currently, generators in the WA electricity market have paid for 'firm' network access rights, meaning they are free to dispatch (sell into the grid) electricity, and thus earn revenue, whenever market conditions suit them. This is called 'unconstrained access'. A major element of the Bills before the committee is to implement 'constrained access', which in effect means that no generator is guaranteed an ability to dispatch.

Although a constrained access model may be desirable in circumstances of high demand and supply growth, it is not necessarily so when the market is experiencing excess supply with the network under speculation of a 'death spiral', i.e. facing declining demand for grid supply and therefore revenue.

Constrained access will change the business landscape for existing generators. Private generators such as Perth Energy have invested in modern power stations, to the State's benefit. These are big investment decisions. One major element in reaching such a decision is the fact that, in this market, the investor has negotiated and paid for a firm contractual right to dispatch. Abolishing this right will adversely impact the revenue stream on which the investment decision was based.

In a different market, with constrained access, different investment decisions may be made. But this is not the case with WA, which has charged investors for the right to unconstrained access. This applies particularly to merchant plants, which have paid for firm access with these rights contained in their access agreements with Western Power.

The problem is that this very complex reform is being implemented in a rush, and this Committee is being asked to approve part only of the scheme without knowing all the details. The government's own EMR Stage 2 steering committee has admitted that it will not have thought through the transitional issues for at least another 6 months, and Parliament will not see the proposed implementation plan for perhaps another year.[2]

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[2] Electricity Market Review, *Information Paper – Transitioning to the National Electricity Regulatory Framework*, 23 June 2016 (available here), section 2.2.3:

> *"Because these matters are likely to have important implications for industry, the Electricity Market Review will commence extensive industry consultation process during the remainder of 2016.*
>
> *To enable sufficient time to conduct the consultation process, the National Electricity (Transitional and Consequential Provisions) Bill 2017 be introduced into the Parliament following the March 2017 election, and passed into law by late 2017."*

The ELAR Bill contains a statutory expropriation of an existing proprietary right

The government knows that implementing constrained access will have serious consequences on incumbent generators – particularly merchant generators, and could expose them to lost revenue and asset devaluation.

This is why clause 120B of the ELAR Bill is included. Clause 120B is an express statutory provision abolishing generators' firm access rights in their contracts with Western Power, and at the same time extinguishing any right they may have to claim compensation from Western Power.

This is an express statutory expropriation of an existing proprietary right, for the specific benefit of the State-owned network business.

This is similar to the changes being implemented for the reserve capacity mechanism, where private merchant assets are being foisted upon significantly higher risk than the framework they had been offered as a basis for their investment. This is set against the background of Synergy having received massive taxpayer subsidies over the years to pay off debt on its very old assets in order to assist such old assets to remain protected in the market.

There is no compensation scheme in the ELAR Bill, and no guarantee that any compensation will ever be legislated

The ELAR Bill contains no compensation mechanism for this expropriation.

The original reform Options Paper in December 2014[3] expressly acknowledged the need to compensate incumbent investors as a result of the abolition of firm access rights, in order to move to a constrained access model.

In contrast, disturbingly, the June 2016 Information Paper makes no mention of compensation,[4] and nor does the ELAR Explanatory Memorandum. This clearly signals a shift in government policy.

If implemented, this would be a shocking example of deliberate sovereign risk. It violates the long-standing convention that the WA Parliament should not expropriate private proprietary interests without fair compensation. This Committee should not assist that violation.

Even if compensation is planned at some future stage, it is unacceptable that it is not being legislated at the same time as the expropriation

Even if, which seems unlikely, the government does still think compensation is appropriate, the committee is presently being asked to approve the Bills in circumstances where there is no certainty about whether or how compensation might be assessed and provided.

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[3] Electricity Market Review *Options Paper* December 2014 (available here), section 7.3.

[4] The 23 June 2016 Information Paper (see footnote 2) does refer in section 2.2.3 to *"a framework to assist existing network users manage changes to the contractual underpinnings for network access brought about by the adoption of the national framework"*, which could conceivably include compensation, but also could mean many other things. It is certainly not any form of commitment that compensation will be available.

At best, all that a private generator would have if the Bills were passed in their present form and caused it loss, would be an uncertain hope that this or a future government might propose some unspecified form of compensation at some unspecified future time. But by then section 120B would be law, the value of its investment may already have been reduced, and it would have absolutely no bargaining power should the future government choose not to act.

Given the experience with the changes to the reserve capacity market, Perth Energy has no confidence that some future compensation will occur.

The fact that government has, by its own admission,[5] not finished thinking through the transition to the new scheme, is absolutely no excuse for the lack of a compensation scheme in the same Bill as the expropriation of private contract rights to firm access.

The Committee should not be a party to this scheme. Section 120B of the ELAR Bill is included specifically to enable the implementation of the uniform national law. The committee should insist that it be accompanied, in this Bill, by a suitable mechanism to determine whether compensation is appropriate and if so to quantify it.

This proposed expropriation for firm access rights is directly inconsistent with the government's stated policy objectives

To devalue private assets in favour of a State-owned asset, without any compensation, is clear sovereign risk and, as with other recent changes such as the Verve-Synergy re-merger, directly contradicts this government's rhetoric about attracting private investment.

As a result, the State will have to incur further capital costs because the burden of future investment in generation assets will fall on it alone.

In addition to deterring future private investments, this form of reckless behaviour makes financiers nervous, which makes it harder and more expensive for existing market players to access low cost funds for the benefit of WA consumers.

Ceding control to national regulators is a one-way step, the Committee should require controls to ensure review provisions to protect WA market participants.

Perth Energy does have a general concern that national rule-makers and regulators, despite their best intentions, will naturally focus on the much larger (and to them more familiar) Eastern States grid and market regime, and may not listen or understand to the concerns of WA based participants or appreciate the WA market's needs as a stand-alone market.

Perth Energy therefore proposes that before WA parliament cedes all control to these national bodies, it include in the Bill a formal ongoing complaint, monitoring and advocacy role for a State body such as the ERA, and a periodic oversight role for the WA Parliament, to ensure that the

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[5] See footnote 2.

wholesale shift to Eastern-States based regulators does not result in WA market participants effectively losing all voice.

Conclusion

Adopting uniform legislation can sometimes be a positive reform. For the electricity sector, doing so in a considered way, with strong and adequate transitional provisions to protect incumbents who have invested in good faith under the old regime, may well be a desirable outcome.

But the Bills currently before the Committee do not fit that description. They are a rushed, ill-thought-through adoption of part only of the national regime, omitting many crucial details that have not yet been worked out, and will not operate appropriately and effectively if enacted. Further, they abolish private contractual rights without any mechanism for fair compensation when appropriate, and do so for the benefit of a soon-to-be-privatised State-owned business.

Such flaws, coming on top of the radically negative changes to the reserve capacity mechanism, will result in unacceptable sovereign risk to WA.

In these circumstances, Perth Energy submits that the Committee should find that the benefits to be gained by the Bills in their current form do not justify the ceding of WA Parliament's sovereignty.

Request to appear

Perth Energy requests that it be permitted to appear before the Committee in support of this submission.

About Perth Energy

Perth Energy is a major participant in the WA Electricity Market supplying 20% of contestable customers including large and small commercial customers as well as government entities of all levels.

Perth Energy has actively supported the electricity reform process within WA over many years and has committed much staff time and effort to this end.

Perth Energy believes that properly considered and implemented reforms can attract private investment, avoid the need for State government investment in generation assets, eliminate the current massive subsidies being paid to State-owned Synergy, and secure affordable, reliable and secure energy for all Western Australians.