

19th September 2018

Mr Matthew Martin
Director, Wholesale Energy Markets
Public Utilities Office
Department of Treasury
Locked Bag 11
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Submitted via e-mail to: PUOSubmissions@treasury.wa.gov.au

Dear Mr Martin,

Improving Reserve Capacity Pricing Signals – A Proposed Capacity Pricing Model

The Australian Energy Council (the “**Energy Council**”) welcomes the opportunity to make a submission to the Public Utilities Office’s (“**PUO**’s”) *Improving Reserve Capacity Pricing Signals – A Proposed Capacity Pricing Model Consultation Paper*.

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over ten million homes and businesses.

Introduction

Following a series of consultations, the PUO has resolved to modify the existing administered capacity pricing arrangement, rather than migrating to an alternative capacity pricing model, which would be subject to complications due to the concurrent market reform processes being undertaken. The Energy Council believes that continuing to use existing measures, including the reliability standard, is entirely appropriate, and the basis for the capacity pricing methodology remains valid.

Nevertheless the Energy Council takes issue with the use of the benchmark new entrant cost of an open-cycle gas turbine as the best basis for the price curve. As noted in our previous submission, it is appropriate for the value of customer reliability (“**VCR**”) to contribute to the determination of the price curve, noting that the value will be affected by such parameters as outage duration and frequency, as well as season, day of the week and time of day. It is noted that the PUO did consider using VCR as a measure to determine the most appropriate capacity payment,¹ but discarded it as being insufficient for meeting the Reserve Capacity Target. To the Energy Council’s mind this seems to suggest that the VCR used is too low, but agrees that rather than going through the process of establishing a more representative VCR, using the parameter to provide guidance on the rate of change in consumer value is reasonable.

While the Energy Council supports the proposed approach with respect to the existing mechanism, it also notes that in the long-term there remains an open question as to whether the capacity pricing model requires a broader review in light of a different supply-demand balance due to the growth of renewable energy. In particular the Energy Council questions whether system adequacy assessment should be primarily focussed upon summer grid peak, and whether the mechanism should be amended to incorporate locational considerations.

Discussion

Demand-side Management

The Energy Council believes that demand-side management can provide value to the market by reducing demand at times of stress. Nevertheless there is significant difficulty in testing for demand-side’s contribution

¹ Consultation Paper, pp.32-33

by quantifying its absence. It is an important principle that all capacity providers, irrespective of technology type are treated equally, but it is clear that demand-side, with its ability to curtail load but not be assessed against what it would have otherwise contributed to peak demand, is not easily comparable with supply-side solutions whose output can be measured directly. Therefore it is entirely appropriate that demand-side resources be required to undergo random testing, and lodge a security deposit to provide some surety to the market that they will perform according to their contracted expectation when called upon to do so.

Generator Closure Notice

The Energy Council agrees that providing adequate notice of expected generator closures is one measure by which market confidence can be improved. The proposed three year notice period has similarities with the proposal currently being considered by the Australian Energy Market Commission, and the Energy Council draws the PUO's attention to the issues raised by the Energy Council in its submission to that body,² viz., the need to avoid conflict with other Acts, the possibility of inconsistencies with directors' duties, and the proper definition of "expected closure date".

Price Certainty Period for New Generation

Attracting new generation is important to maintaining capacity in the market and investor risk is an important consideration when projects are being assessed, but much like the risk investors take on when they decide to build new generation and participate in the energy market, participation in the capacity market is a conscious decision taking into account the likely risks, rewards and costs of market entry. At face value providing price certainty for a five year period will reduce project risk, but it needs to be balanced against the possible market distortion effects. The Energy Council has considered the advantages and disadvantages of each position, and on balance, cautiously accepts that a price certainty period will be in the overall best interests of the market.

Transitional Measures

The inclusion of transitional measures for existing generation is welcomed, as a means by which the risks to existing generation of having the rules under which they invested changed can be reduced. To this end the Energy Council supports the proposal, although it is suggested that the upper band be adjusted such that the forecast capacity outcomes in later years be able to remain within the pricing bands.

Implementation Timing

There is significant market reform occurring in the Wholesale Electricity Market, and while the Energy Council favours implementation in the 2020 Reserve Capacity Cycle in order to give industry time to accommodate the transition, it is appreciated that this will coincide with the planned constrained network access model implementation reform. Therefore the Energy Council agrees that implementing the revised Reserve Capacity mechanism for the 2019 Reserve Capacity Cycle seems appropriate.

Conclusion

In conclusion, the Energy Council is supportive of the broad changes proposed to the Reserve Capacity Pricing mechanism, and considers that some minor changes will enhance its efficiency.

Any questions about this submission should be addressed to the writer, by e-mail to Duncan.MacKinnon@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,

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² <https://www.aemc.gov.au/sites/default/files/2018-06/Australian%20Energy%20Council.PDF>