synergy

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Mr Zaeen Khan
Executive Director, Public Utilities Office
Department of Treasury
David Malcolm Justice Centre
28 Barrack Street
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via email: puosubmissions@treasury.wa.gov.au

Dear Mr Khan

SUBMISSION ON IMPROVING RESERVE CAPACITY PRICING SIGNALS

Thank you for the opportunity to provide feedback on the Department of Treasury's draft recommendations outlined in the paper, *Improving reserve capacity pricing signals – a proposed capacity pricing model*.

As indicated in its submission in response to the previous consultation paper, Synergy supports refining the existing administered pricing approach to remunerating reserve capacity. Compared to the alternative approaches considered, refining the administered mechanism appears most likely to be administratively efficient, deliver efficient price signals and least cost outcomes, and be fit for purpose within the South West Interconnected System (**SWIS**).

Synergy commends the Department of Treasury for recommending the retention of the administered mechanism, with some refinements. Following is feedback on specific aspects of these refinements.

Demand response capacity

Synergy is the largest provider of demand response capacity in the SWIS and considers that this form of capacity can provide an important service to the market. Despite reforms already completed that align demand response more closely with other forms of capacity, some notable differences remain.

Synergy therefore supports the proposed requirement for demand response to undergo random testing and provide a security deposit. This will give market participants greater certainty that this capacity will be able to be called upon and perform as intended.

However, for demand response capacity where the capacity to be certified is a specified and previously proven, reliable, fixed load program, it appears inefficient to require ongoing security deposits and randomised testing (in the event the randomised testing for demand response is intended to be any more onerous than for other capacity types). These measures are likely to add unnecessary and inefficient costs to the provision of otherwise proven, fixed load demand response capacity and also likely to result in unnecessary and costly barriers to market entry for demand response providers.

An additional requirement for demand response providers to have a reference indicating the location within the SWIS from which the capacity will be sourced would support market participants' confidence in demand response delivering a valuable service. This will also be important for the interaction between the reserve capacity mechanism and the proposed change to constrained network access.

There may still be an incentive to introduce unnecessary new demand response to the market in excess capacity conditions because the likelihood of dispatch for peak demand purposes remains very low. As such, further rigorous harmonisation of these different capacity types and further consideration of the appropriate remuneration structure for demand response across capacity and energy markets is likely to improve the efficiency of market outcomes.

Capacity withdrawal notice

Capacity withdrawal notification timeframe requirements that are common across the SWIS and National Electricity Market (**NEM**) may provide market participants and other stakeholders improved certainty of market dynamics. However, aligning the SWIS and NEM should not be an objective in its own right, given the extensive and appropriate differences between other aspects of these markets. For example, two years' notice is already afforded by the reserve capacity process in the SWIS.

Consideration will need to be given to the method by which the notification of withdrawal is proposed to be conveyed to the market and the means by which it is intended to be enforced. For example, enforcing the withdrawal notice period may create a barrier to efficient capacity exit if it obliges capacity to remain in the market when it was otherwise intending to withdraw, counter to one of the objectives of reforming the reserve capacity mechanism.

In any event, an exception from enforcement, potentially administered by AEMO, will also be required where market dynamics or extenuating circumstances mean changes to capacity withdrawals must occur within the notice period. Without such an exemption, there may be unnecessary complexity and additional administrative or legal costs for companies where the requirements of the notice period are inconsistent with requirements under other legislation, such as occupational health and safety legislation or environmental protection legislation.

Price lock-in for new capacity

Attracting new generation in periods of very low excess capacity is an important attribute for the reserve capacity mechanism and reliability of the SWIS. The opportunity to lock-in a price could improve investment certainty for proponents. Synergy understands the lock-in price (and term) will only be offered in the event the reserve capacity target is not met through capacity offered at the floating price (i.e. excess capacity is 0%).

However, the price lock-in may create market distortions in some scenarios where it is offered. For example, proponents could annually propose speculative projects at the maximum capacity price and, in the event the lock-in price capacity is required in a particular year, there would need to be a prioritisation of proposed lock-in projects, otherwise there could be a substantial increase of capacity if all these projects are procured. The latter scenario would result in high capacity price volatility for incumbent generators the following year, while the new entrant project proponents would be protected for a five year period.

Price certainty will be beneficial for proponents. While the lock-in price is unlikely to be a key feature of the SWIS in the medium term due to forecast capacity adequacy and declining grid connected load, it appears further consideration may be required to ensure the lock-in option does not result in perverse incentives in the longer term.

Energy storage technologies

Any changes made to the administered pricing mechanism should not impede or preclude consideration of future changes that may be required to accommodate the expected increased participation of utility scale storage. Further consideration will also be required regarding the role and services that can be provided by utility scale storage, such as generation capacity and ancillary services.

Transitional arrangements

Transitional arrangements are appropriate to support the proposed refinements to the pricing method because these refinements introduce a change to the arrangements under which incumbent generators have made investment decisions.

Given AEMO's 2018 Electricity Statement of Opportunities has been used as an independent forecast to inform setting the lower and upper bounds for the transitional capacity price, and given the transitional price is forecast to exceed the upper bound within the 10 year period, it would appear appropriate for the upper bound to be raised to capture the forecast price over the entire period. The upper bound should therefore be set at approximately $135,000/MW.

Implementation considerations

Implementing the proposed changes as soon as possible may better sequence the impact of the broader suite of electricity sector reforms, and the burden the changes may have for market participants, rather than progressing these changes concurrently.

However, the challenges of refining the details and making the associated changes to market rules may mean it is not feasible for the changes to be introduced any faster than concurrently with the proposed adoption of constrained network access.

Should you wish to discuss these matters further, please contact Mr Jason Froud, manager, policy, on 08 6282 7395 or jason.froud@synergy.net.au.

Yours sincerely

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