

4th May 2018

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

Dear Mr Martin,

Improving Reserve Capacity Pricing Signals – Alternative Capacity Pricing Options

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 – Alternative Capacity Pricing Options 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

The PUO is seeking industry views on possible alternative pricing options for the West Australian Reserve Capacity Mechanism in advance of a capacity auction mechanism being developed sometime after 2021. The Energy Council is supportive of mechanisms which reinforce market pricing outcomes, are economically efficient, fairly disbursed between market participants, and encourage liquidity. As the estimated level of excess capacity for the 2018-19 capacity year is four per cent¹, the urgency of a stable mechanism which provides these attributes and encourages industry investment is apparent.

The PUO has proposed two possible alternatives to a capacity auction arrangement, being:

- Option 1: Administered Pricing; and
- Option 2: Retailer-led Contracting Obligation.

Administered Pricing

Under this option the capacity price would continue to be set by reference to the formulae set out in the *Wholesale Electricity Market Rules*. As the PUO correctly points out, the existing formulae have a constant slope for all levels of excess, and the Energy Council agrees that this results in the signals for market adjustment being muted. Instead the Energy Council supports the formulae being recast to provide a “steep-shallow-steep” price curve which provide the right incentives for industry investment.

While such a price curve should be related to the value of capacity for electricity users, the Energy Council disagrees that the benchmark new entrant cost is the best basis for the price curve. Instead it is appropriate for the value of customer reliability to contribute to the determination of the price curve, and it is worth noting the parameters which affect value of customer reliability such as outage duration and frequency, but also season, day of the week and time of day. Therefore the Energy Council believes that the probability of loss of load to which the Consultation Paper refers² is inversely correlated with the price curve rather than affecting it.

¹ Consultation Paper, p.3

² p.14

Retailer-led Contracting with a Bulletin Board Trading Mechanism

In contrast, the second proposal, Retailer-led Contracting with a Bulletin Board Trading Mechanism, is a fundamental change to the Reserve Capacity Mechanism as it establishes capacity certificates, which can be traded, either bilaterally or via an exchange.

The paper indicates that each retailer would be required to contract sufficient capacity to meet its individual share of peak load³, however the paper does not specify how each retailer's peak load would be determined by AEMO, and the basis for such determination, e.g. a 1-in-2 peak, or perhaps a 1-in-10 peak. Such an assessment has the potential to create excessive costs for retailers, which will ultimately be borne by consumers. The Energy Council submits that the assessment process should be developed by AEMO in consultation with market participants in order to provide the most efficient outcome.

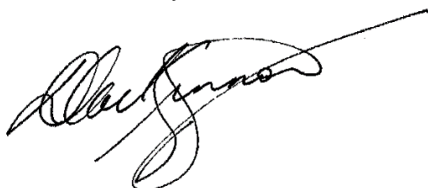
In a deeply competitive market, by establishing capacity certificates and "floating" the capacity price in this way, the level at which the price settles would be reflective of the efficient price for the prevailing supply-demand balance. However given the small size & structure of the Wholesale Electricity Market, this option may require regulatory constraints that could defeat its benefits, similar to the challenges a reserve capacity auction would face. On this basis the Energy Council supports the theoretical development of this option only, particularly as it is apparent that it will take significant time to design and implement the scheme. The Energy Council does note, however, that some of the trading principles developed may prove useful in the development of a hybrid pricing model, which would take the best attributes of Administered Pricing, and allow trading, so parties could extract value and optimise their positions.

Conclusion

In conclusion, the Energy Council believes that Administered Pricing is the preferred option for the Reserve Capacity Mechanism, subject to the appropriate determination of the applicable price curve.

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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³ p.v