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Dear Mr Martin

RESPONSE TO CONSULTATION PAPER - ALTERNATIVE CAPACITY PRICING OPTIONS

Bluewaters welcomes the opportunity to provide comments on the paper entitled "Improving Reserve Capacity pricing signals – alternative capacity pricing options (The Paper). This paper was published by the Public Utilities Office (PUO) on 9th April 2018.

The Paper presents a review of capacity pricing options in electricity markets in Europe and North America with the five approaches commonly used being:

- Strategic reserves
- Capacity payment/Administered capacity payment
- Capacity obligations
- Reliability options
- Capacity market auction

Bluewaters notes the common features that are evident in the market design reviews and agrees with the comment regarding the Reserve Capacity Mechanism:

"Western Australian Reserve Capacity Mechanism appears as a rather unique hybrid design, given that it has a reliability obligation together with a centralised procurement based on an administered pricing curve. Also, it allows the market operator to contract for all capacity that is certified regardless of the level of market excess. There is no equivalent to this approach in the European Union and North American markets reviewed.

However, the Western Australian capacity market is also very small in comparison to all these international markets"

The relative size of the capacity market is a significant hurdle to be considered as this fact together with the significant dominance of 1 Generator/Retailer limits the effectiveness of price discovery models that other markets have.

Alternative capacity pricing options

The two options presented in the paper demonstrate adaptations to the international markets approaches. Bluewaters considers that with significant market change expected over the coming years, any change to the capacity mechanism should be minimal so that review of the wholesale changes needed to the market can be pursued with the appropriateness of the overall capacity mechanism included.

For this reason, Option 1 is considered a simpler option to implement compared to Option 2 as:

- Option 2 is a more fundamental change. Hence, consequential changes to the Market Rules need to be considered. For example, how would the capacity refund be quantified in the absence of a reserve capacity price? Changes under Option 1, on the other hand, are likely to require less consequential changes in the Market Rules.
- Under Option 2, the capacity contracting is likely to be less transparent compared to the Option 1 mechanism where capacity trading is expected to be centrally administered (and centrally priced) by the AEMO. This makes market power monitoring and mitigation far easier (and less costly) under Option 1. Market power monitoring and mitigation under Option 2 may require review of private contracting information of the generators and retailers. Some of this information may be commercially sensitive. Effective access to this information would be onerous if not impossible.

- Given that bilateral capacity contracts are already well in existence in the WEM, complex challenges are likely to arise in integrating the contracts under Option 2 into the existing capacity contracts.

Should you have any questions regarding this submission please contact Daniel Kurz on 08 9261 2881 or daniel.kurz@bluewatersps.com.au.

Yours sincerely

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