



03 May 2018

Mr Matthew Martin
Director, Wholesale Energy Markets
Public Utilities Office
David Malcolm Justice Centre
28 Barrack Street
Perth WA 6000

Submitted via email to PUOSubmissions@treasury.wa.gov.au

Dear Matthew,

Improving Reserve Capacity pricing signals – alternative capacity pricing options

ERM Power Limited (ERM) welcomes the opportunity to provide comment and feedback on the Public Utilities Office (PUO) paper on *Improving Reserve Capacity pricing signals – alternative capacity pricing options*. ERM provides the below commentary in order to assist the PUO in the development and thinking in relation to improving the Reserve Capacity pricing signals.

About ERM Power

ERM Power Limited (ERM) is a listed Australian energy company (EPW) operating electricity sales, generation and energy solutions businesses. The company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load, with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services, including lighting and energy efficiency software and data analytics, are being delivered to the company's existing and new customer base. ERM Power also sells electricity in several markets in the United States. The company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. It is the only retailer in Australia to operate in every state.

General Comments

The SWIS is small in size in comparison to the majority of domestic and international electricity markets and also faces the challenges of being an isolated market. The fact that the SWIS is isolated and cannot be reliant on energy transfers from other states means that energy reliability is at the forefront of the energy security and reliability picture for Western Australia. The Reserve Capacity Mechanism (RCM) is one of the means by which the SWIS is able to maintain reliability through the procurement of sufficient capacity to meet times of peak load demand. The most recent changes to the RCM have resulted in the reduction of the volume of capacity offered in the WEM, primarily through a reduced participation of demand response. This followed by a Ministerial Direction to Synergy for the retirement of 380MW of plant has resulted in a tightening of the supply/demand balance for a peak summer load day.

The WEM itself is also undergoing a transformation that could result in a significant change to the generation mix in the SWIS, through the installation of more renewable generation facilities, which could lead to stranding of traditional generation facilities. This is already evident in the SWIS through signs of 'Two-Shifting' of traditional coal fired generation units that previously would have been operational with minimal stops and restarts all year round.

The objective that the PUO is trying to achieve with this reform process is to ensure a pricing mechanism is in place that maintains a relatively balanced supply/demand equation, such that there is not an overabundance of capacity and that consumers don't end up paying too much. However, the generation mix is changing more rapidly than policy and regulatory development and the question has to be asked, is the PUO addressing the correct issue by pursuing alternative capacity pricing options? Should the PUO be looking instead at the generation mix and technological changes and addressing the bigger strategic issues of what is the energy future of the SWIS going to look like and how does the SWIS transition to that future? These fundamental issues need to be addressed first and foremost to ensure the security of the SWIS. ERM believes that looking to change the reserve capacity pricing mechanism before addressing these issues will not ultimately achieve the PUO's objectives.

Until the PUO addresses the higher level strategic future of the SWIS, which could lead to different means of pricing capacity, there is no reason for deviating significantly from an administrative pricing process. Too much focus on an appropriate reserve capacity pricing mechanism could result in valuable time and attention taken away from the strategic issues which are of utmost priority.

Comments addressing PUO's paper – Option 1 versus Option 2

Given the size of the SWIS and the uncertainty surrounding its strategic future, ERM believes the complexity and effort involved in assessing alternative capacity pricing options is not required at this point in time and that an administrative pricing methodology should be retained.

The PUO's main criticism of the administrative pricing methodology is that it does not appear to react fast enough and send the correct price signals in times of under or over supply in the SWIS. This methodology however, is transparent and provides some level of certainty for market participants with that transparency. Customers that are exposed to the RCM can see how the price of the capacity credit is determined. There is a market benchmark price that is calculated in a transparent way with the mechanism administered by an independent party, the Australian Energy Market Operator (AEMO).

ERM believes the current administrative pricing methodology would require only slight adjustment to provide better pricing signals to the market to highlight under or over supply situations. Even without amendment however there currently is transparency in how price is determined, which is vital to market function.

Conversely, ERM believes the Retailer led methodology (Option 2) would present multiple and complex issues for the WEM operation. The PUO has recognised that there are market power issues to be dealt with if Option 2 was adopted. It's not just market power issues that need to be dealt with but also transparency issues in what the market price of capacity might be. Retailers will have the obligation to procure sufficient capacity to meet its requirements and if it does not procure sufficient capacity, it could be faced with debilitating penalties. The ability for Retailers to pass on the full cost of procured capacity could also be difficult without a transparent market price. A bulletin board mechanism

equates to a pseudo auction mechanism which, if the penalties are set too high, could result in shadow pricing the penalty price applied. Competition could be disrupted under this model if market power issues are not addressed appropriately.

Demand Side Management/Demand Response

ERM as a retailer has always offered Demand Response (DR) as a retail-led product. DR has value as a retail product and should not be a wholesale product. DR is not physical generation and does not share the same cost imposts that a physical generator faces. If DR is to participate in the capacity market, it should do so as a fully available 'generator' that faces the same penalties as a fully available generator in order to receive the full price of a capacity credit.

If DR does not participate in the capacity market, there are still options for it to participate in the Supplementary Reserve Capacity (SRC) auction when activated.

Summary

The SWIS is changing quite rapidly with the advent of roof top solar PVs and large scale renewable facilities. These technologies are driving fundamental change to the way the SWIS has operated and will pose as significant game changers in the way the SWIS will operate in the future. Reserve Capacity pricing is an important element in the whole equation but until there is clarity on how the system can be transitioned to the new world of green energy, there is no reason to change the way a capacity credit is priced. Reserve Capacity pricing could be part of the solution for the future but there needs to be a fundamental shift in thinking before we get there. Until then, to maintain the stability and transparency in the Reserve Capacity Mechanism, a modified administrative pricing mechanism is all that is required.

Please don't hesitate to contact me at wng@ermpower.com.au or on 08 6318 6416 if you would like to discuss any of the views outlined in this submission.

Yours sincerely

A handwritten signature in blue ink, consisting of a series of connected loops and a final vertical stroke with a horizontal crossbar at the bottom.

Wendy Ng
Commercial Manager WA