Wholesale Electricity Market
Rule Change Proposal Submission Form

RC_2013_20 Changes to the Reserve Capacity Price and the dynamic Reserve Capacity refund regime

Submitted by

Name:	Ky Cao
Phone:	08 9420 0300
Fax:	08 9474 9900
Email:	k.cao@perthenergy.com.au
Organisation:	Perth Energy
Address:	Level 24, Forrest Centre, 221 St Georges Tce, Perth WA 6000
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Submission

Thank you for the opportunity to provide a further submission in relation to Rule Change Proposal RC 2013 20 “Changes to the Reserve Capacity Price and the dynamic Reserve Capacity refund regime”.

RC 2013 20 was submitted by the Independent Market Operator (IMO) on 10 January 2014. Perth Energy subsequently provided a consultation response during the first consultation round.

After following the normal consultation process RC 2013 20 has had its timeline extended via Rule Change Extension Notices a number of times to allow the IMO to consider the outcome of the Electricity Market Review. We understand that the IMO is now looking to finalise the consideration of this Rule Change Proposal following a request from the Minister for Energy to resume the 2014 Reserve Capacity Cycle and progress this rule change proposal to provide certainty to applicants for the 2014 Reserve Capacity Cycle.

Perth Energy continues to be opposed to this Rule Change Proposal and our views have not changed from those we provided in our initial consultation response.

We would like to take this opportunity to make the following final observations ahead of the IMO’s decision on this Proposed Rule Change.

CRC Pricing

We have for a long time advocated reviewing the way the Reserve Capacity Market (RCM) operates to reduce price volatility. The whole reason for the existence of the RCM is to provide price stability for generation capacity. For infrastructure assets, price resets should only apply to new entry, not existing assets that have passed the gate fairly and efficiently according to the Market Rules – the call of the system – those classified as merchant plant.

The generation assets that have entered the SWIS outside the Market Rules – the non-merchant plants – are those contracted to Synergy under the Vesting Contract's capacity displacement program. This Vesting Contract related capacity is the root cause of the current excess capacity situation because under the Vesting Contract Verve's displaced capacity should have been closed down once it had lost its bids to supply Synergy.

To cause Reserve Capacity Price (RCP) volatility because of an excess of Vesting Contract related capacity is a total failure in understanding the SWIS and managing the RCM.

The proposed changes to the calculation of the administered price are significant and would result in an even more volatile pricing regime than is currently the case, in a market considered to be appropriately an infrastructure market. Stability of earnings is paramount in this market to avoid substantial risks being priced into project financing costs and the spectre of all new investments having to be underwritten by the State emerging. The objectives of the Market Rules are to facilitate competition in the market, and increased RCP volatility without reasons will only lead to more concentration of generation capacity in government hands, something the government has stated publicly it does not want.

If implemented, the changes will further dent investor confidence with potential long term adverse impacts for private sector investment in generation capacity in the WEM.

We are not referring to just new plant investment but also potential private sector purchases of Synergy assets should the Government proceed with divestment of certain assets to improve competition in the market or for other public policy purposes. Without confidence in the WEM, there would be no divestment possible and private participation will shrink over time, leading to the ultimate demise of the WEM.

Demand Side Management

If there is to be some early Rule Change Proposals from the IMO, they should be directed to the treatment of DSM. Perth Energy continues to be extremely concerned with the significant amount of CRC awarded to demand side providers of capacity. For the 2015/16 Capacity Year, a total of 551MW of CRC has been awarded to demand side providers. This represents almost the entire oversupply of CRC for that year (564MW).

The steps taken by IMO to improve the value of DSM through RC 2013 10 "Harmonisation of Supply-Side and Demand-Side Capacity Resources" only highlight the fact DSM is not equal or equivalent to generation capacity. The proposal in RC 2013 10 includes increased availability requirements and a requirement for telemetry at demand side provider sites to allow System Management close to real time visibility of the Facility's ability to provide capacity. The proposal still misses the entire point that DSM is balancing energy or balancing capacity at best, and not peaking capacity that is built to satisfy a clear and predictable portion of the Load Duration Curve.

In our view, demand side load reduction should not be allocated CRC but should instead have the opportunity to be competitively procured in the market by retailers for CRC replacement value if such value in fact exists, or as a complimentary ancillary service of load reduction to System Management.

The role of DSM should be addressed urgently in phase 2 of the Electricity Market Review with the aim of developing a Rule Change Proposal to remove DSM as a provider of CRC within the Market Rules as soon as possible.

Continued Uncertainty of Electricity Market Review

The changes contemplated by this Rule Change Proposal are significant and also comes with a significant implementation cost estimated in the range of $285,000 - $440,000 for the IMO alone. On 24 March 2015 the Minister for Energy provided the market with his views on the outcomes of Phase 1 of the Electricity Market Review (EMR) and provided guidance for the focus areas of Phase 2 of the review. One of the focus areas for Phase 2 will be the capacity market with the potential for significant changes to flow from the EMR

Perth Energy is concerned that if this Proposed Rule Change were to go ahead and potentially be reversed by initiatives flowing from the EMR shortly this will lead to an unnecessary cost burden being placed on Market Participants (who directly fund the IMO's activities, including change management via payment of Market Fees).

Secondly, and more importantly we are concerned that investor confidence may be significantly dented if such significant changes were to be forced through whilst the overall direction of the Wholesale Electricity Market is being reviewed with the potential for wholesale changes in the near future that may reverse any amendments flowing from the Proposed Rule Change. One of the stated objectives of the EMR is to improve the ability to attract significant private sector investors to the WEM.

Appropriateness of Recycling Refunds to Generators

Perth Energy continues to be opposed to the idea of recycling capacity credit refunds to generators instead to Market Customers as is the case currently. In our view, Market Customers pay for all capacity credits provided in the WEM. When some of those capacity credits are unavailable the only reasonable outcome is that the customer who originally paid for the capacity credits receives any refunds that may be available. This does not in any way represent an inefficient value transfer from generators to Market Customers.

The outcomes of 28th of January this year serves as a good example of some of the perverse outcomes that may result from recycling capacity refunds to generators. Over 1,000MW of capacity was on Forced Outage and the Balancing Price went to the price cap. With the Forced Outages, Market Customers were not receiving the capacity it had already paid for through capacity credits. On this premise alone, Market Customers should receive the capacity credit refunds. Secondly, the generators that remained in service were rewarded for the scarcity caused by other parties in the form of significantly higher energy prices. Most generators responded accordingly and made more energy available and earned higher revenue.

Given that generators make more money due to the higher prices, Perth Energy cannot see in any circumstances the rationale for recycling the refunds – the remaining generators not on outage still receive their capacity credit revenue and higher energy prices. Market Customers are exposed to higher energy prices caused by the outages and should at least be given back what they have already paid for but are not fully receiving (that is all the capacity credits certified in the market).

Perth Energy provided a suggestion in its previous consultation to specifically allow for Forced Outages when determining the Maximum Reserve Capacity Price (MRCP). In the Draft Rule Change report the IMO dismissed this as being "not feasible" due to the fact that different generation and demand side technologies have different expected outage ratios. Perth Energy is disappointed that the IMO is unwilling to follow this any further on the basis that it will be impossible to achieve 100% accuracy. We believe our suggested approach would significantly improve the accuracy of the MRCP compared to status quo despite not delivering a 100% accurate result.

We observe that compromises where different service providers are given the same treatment despite having significantly different characteristics already exists within the Market Rules. For example, providers of Certified Reserve Capacity (CRC) are assigned to different Availability Classes with some only required to be available for 24 hours per year (demand side providers) whilst Scheduled Generators are required to be available for all Trading Intervals. Despite the difference in availability requirement a one size fits all approach is adopted within the Market Rules for valuing the CRC provided from different Availability Classes. All providers are paid the same $/MW rate for their capacity regardless of their availability.