WA Major Energy Users

(WAMEU)

Electricity Market Review

Response to Position Paper on Reforms to the Reserve Capacity Mechanism dated 3 December 2015

29 January 2015

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Altus ENERGY STRATEGIES

WA Major Energy Users **(WAMEU)** is an energy market interest group for large energy users in WA.

WAMEU was established in 2007
Arrangement. The submission from WAMEU was one of few received from users by the Economic Regulation Authority (ERA) and contributed significantly to the debate. The exercise was repeated again in 2011, with a similar group of participants, for another Western Power network tariff re-set.

During previous reforms and already as this one starts, major users (those who pay the bills for energy in WA) often have little to no involvement in the discussions that shape the energy industry.

WAMEU is funded by major energy users that operate energy intensive businesses in WA and most recently made a submission in response to the Electricity Market Review Discussion Paper in September 2014.

WAMEU welcomes assistance from the Government of Western Australia in promoting and supporting participation from energy end-users in WA.

WA Major Energy Users (WAMEU) is supported by consultants energyXL and Altus Energy who have extensive experience in the WA energy industry.

Summary Response

The key focus of this submission by WAMEU is on the proposed differential payment of Demand Side Management (DSM) generation capacity in the market. DSM should receive the same capacity price as other capacity providers; this is a fundamental economic concept in energy markets.

DSM prevents unnecessary investment in inefficient capacity. Where a capital investment is made by industry (mining crushing plant, back-up generation for a hotel), providing DSM capacity leverages the investment cost with a benefit for the electricity market.

The proposal for a capacity auction when and if the supply of capacity becomes closer to balanced is supported with the caveat that it should be open to participation by end users on a non-discriminatory basis. As growth occurs in PV and renewable generation, it is perhaps unlikely that an auction will occur in the medium term if at all.

The proposal to further tighten the quality of DSM resources by altering the calculation of capacity contributed from 32 data points over the summer months to the 95th percentile of contribution during the highest 200 hours of grid load is supported on a qualified basis. This will reduce DSM resources by 220 MW (40%) according to the PUO calculations. This change must support the retention of payment of the full capacity price for DSM, and it appears that this change would also increase the average capacity price.

A proposal to amend the slope of the price decline for over-supply to negative 5 is supported. This on its own will reduce the capacity cost in the market to reflect the over-supply. It is somewhat arbitrary, but subsequently reducing capacity in the market will drive the price up again.

The combination of the previous two measures is posited to reduce the cost of capacity in the market by $35 M per annum. This benefit will flow to retailers, not direct to customers. Industrial and SME customers which participate in DSM will see an increase in their net-cost of energy if the differential payment of DSM is progressed during the

It makes sense that the capacity price should be lower when there is excess capacity, and that as the price fell capacity may choose to exit the market if that price
target a single segment of generation (DSM is generation) in a diverse system is a cynical move by the WA energy industry to increase the bottom-line energy cost for business while improving retailer margins.

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The WA government owns the largest generator and retailer in WA (Synergy) and can also decide which reforms progress They can alter the rules of the game, causing winners and losers.

The suggested changes are clearly designed to benefit Synergy. If the government likes them, the PUO will be instructed to implement them. The objective is still to reduce the franchise over domestic consumers.

None of this breeds confidence in the process.

Selecting DSM (because it is outside the retail energy industry) and proposing it receive differential payment in the capacity market is a retrograde step.

Demand Side Management in Reserve Capacity

Many industrial consumers participate in the capacity market through DSM. This has been driven by the market mechanism enabling the hedging of capacity charges by offering DSM capacity. These are generally large block loads that are paid to respond to dispatch instructions from System Management. The performance is tested and non-performance has implications via penalties.

DSM was supported and promoted in earlier reforms, provides capex savings on power stations, enriches the market through greater diversity, encourages end-user participation in the market and is the lowest emission generation capacity available in the SWIS.

WAMEU strongly supports DSM as an equal participant in the capacity mechanism in the WEM.

The market should not discriminate against any particular capacity type. Wind and solar are not dispatch-able, they receive capacity payments related to their contribution to meeting peak demand. DSM is dispatch-able and should receive payment of the same capacity price as all market participants.

It is a fundamental market principle that all capacity should receive the same price. Citing different cost drivers misses the point. In fact, cost drivers are not the main game in regard

(Power Purchase Agreements, or PPA s) which return the costs of capital outlay and operation over the long term. This is not the same as a capacity payment, which is an artificial construct to ensure that all capacity not covered by an offtake agreement is paid, and that the cost of this is allocated to all retail customers.

Capacity revenue can be viewed as

capacity revenue rewards such a plant. The capital cost of a new build industrial plant (eg. Simcoa 3rd furnace) was in part justified as an investment in WA as opposed to elsewhere in the world through the contribution from DSM capacity payments.

Changing the DSM Business Model

The earliest DSM in WA pre-dates the WEM. Simcoa and Cockburn Cement have provided DSM since the late 19 capacity price was approximately $100,000 per MW/year.

Not all DSM is the same. Aggregated portfolio programmes may not be as well-placed to support market objectives as large individual industrial loads.

Industrial loads should participate directly in the capacity market. They should be paid for their contribution at system peak to maintaining the reserve margin at the reserve capacity price. DSM providers should be registered with The Market Operator and the capacity payments for DSM made as an offset to their IRCR cost. This would enable portability of DSM for industrial capacity as the retailer that supplies the load would receive the net capacity charge after deducting for the capacity payment related to DSM.

Who Are the Winners From Differential Payment for DSM?

The cost of capacity is paid to providers by entities that use it. Retailers are required to cover the IRCR of their customers in aggregate.

Retailers all pay for capacity, and some own capacity through their own power stations or Each retailer will have a position on capacity purchased versus IRCR.

By definition the retail segment is a net buyer. DSM and a few merchant plant are the only entities that are not tied to retailers through PPA or internal bilateral. This short position held by retailers pays off through a reduction in the price and quantity.

Most customers will have pass-through provision for IRCR costs; others will have this built into the price with a risk premium added for its potential to increase.

Retailers may

A quote in the AFR last year

The measures in the table firm up the capacity provided by DSM to the market and should ensure that the full capacity price continues to be paid for DSM with no differential treatment. The quantum of available hours is perhaps excessive, and the further difference in calculation of IRCR should be subjected to further analysis.

Implement the dynamic refunds proposal developed by the IMO

Supported

Implement the refunds recycling proposal developed by IMO with limited changes

Supported

Implement generator availability proposal developed by IMO with minimal changes

Supported

A single slope of the capacity curve of -5 for the duration of the transition period

Supported

Increase capacity price cap

Supported

Differential treatment of capacity payments for DSM

Not supported. The changes proposed to be implemented by table 6.1 reduce the amount of