

28 January 2016

ABN 56 149 910 341

Electricity Market Review Project Office
Public Utilities Office
Department of Finance
Locked Bag 11
Cloisters Square WA 6850

Via email: electricitymarketreview@finance.wa.gov.au

Dear Mr Martin,

Reserve Capacity Mechanism Position Paper Response – Tersum Energy Pty Ltd

Tersum Energy Pty Ltd (“**Tersum**”) welcomes the opportunity to provide comments and input on the proposed Reforms to the Reserve Capacity Mechanism, within the context of the Western Australian Electricity Market Review.

Tersum is currently developing its first project, a mid merit – solar hybrid power station, to be connected to the South West Interconnected System (“**SWIS**”) in the locality of Meru, approximately twelve kilometres south-east of Geraldton.

As a new participant in the Western Australian Electricity Market, Tersum supports the general principle of increasing competition through market reform. Tersum holds the view that such changes are required to drive positive outcomes for customers, market participants and ultimately the state of Western Australia.

Reform Objectives and Principles

A change to the Reserve Capacity Mechanism is an important step in the reform process which is intended to promote efficient decision making. This should lead to timely investment to meet the specific needs of the market, resulting in a re-balancing in the mix of generation within the SWIS, through private investment (while not excluding other new technologies).

Change in itself will not deliver the expected outcomes. A strong commitment is required by policy makers, regulators, the state and existing market participants to embrace the need for change and take the appropriate commercial decisions necessary to create the opportunity for new private investment, into what is a relatively small market. Consideration should not only be given to the existing market, but to the market of the future, where a continued up-take of personal generation through roof-top solar and storage needs to be accommodated. We should embrace the disruption and look to develop a robust and responsive market through the Electricity Market Reform process.

Process to implement transitional reforms and capacity auction

The Position Paper divides reform up in to two stages. The first stage involves transitional arrangements for a period till the introduction of the auction and second stage involves the adoption of an auction as the basis for the procurement of capacity.

The transitional arrangements proposed can be summarised as:

- The formula for calculation of the Reserve Capacity Price is changed to have a steeper pricing curve for capacity: a price slope of negative five rather than the existing slope of negative one.
- Demand side management (DSM) be removed from the Reserve Capacity Mechanism and subject to different administered- price arrangement.
- Proposed measures to strengthen the incentives on capacity providers to make capacity available for dispatch, including dynamic refund pricing reflecting the volume of surplus capacity, with capacity refunds returned to market generators. A limit on the amount of capacity refund exemptions due to planned outages will be introduced.

Tersum supports all the above changes to be introduced as part of the transitional stage. These are positive changes will lead to more efficient decision making. Tersum would suggest that further work still needs to be undertaken on the value in the form of capacity that DSM offers the market. It is particularly a peak demand periods that the system cannot produce the energy required. DSM should be recognised not as providing guaranteed capacity as a power station but rather removing energy and it is the value of that energy, whenever not consumed that should be rewarded at market prices. It does not fit in to the category of firm capacity.

The Position Paper provides a detailed overview of specific market based capacity mechanisms, working to deliver strong outcomes, in particular sufficient capacity from private investors to achieve reliability objectives at lower than expected costs. The Position Paper then advocates for an auction approach.

At the same time the Position Paper clearly identifies differences between the markets in North East United States and the Wholesale Electricity Market. In particular the PJM is used as an example to for the proposed auction approach. Tersum does not oppose the auction approach but it maybe worth reflecting on the PJM experience.

In June 2007 PJM began its first delivery year under its new forward capacity market. The stated purpose is to enable PJM to obtain sufficient resources to meet the reliability of consumers within the PJM while:

- Supporting load serving entities to satisfy their capacity obligations for future years;
- Administering competitive auctions to secure additional capacity resources, demand response, and qualifying transmission upgrades to satisfy load serving entities unforced capacity obligations that are not satisfied through self supply;
- Recognising the locational value of capacity resources in the auctions; and
- Using a backstop mechanism to ensure that sufficient generation, transmission and demand response solutions will be available to preserve system reliability.

The key design elements of the PJM which facilitated this were:

- A mandatory three-year forward resource adequacy requirement, based on target reserve margins,

- A downward sloping (rather than vertical) demand curve that determines required reserve margins as functions of capacity prices,
- Locational capacity prices that are able to reflect the greater need for capacity in import-constrained areas,
- Provisions that allow demand-side resources and new transmission projects to compete with generating capacity,
- Accommodation of self-supply and bilateral procurement of capacity,
- Annual, PJM-administered "base-residual" and "incremental" auctions that clear capacity supplies against a downward sloping demand curve and procure residual capacity needs (i.e. Capacity not already self - supplied through resource ownership or bilateral contracts) on a forward basis, and
- Explicit market power mitigation rules.

Reports found that the PJM market had been successful in encouraging new investment in new capacity and maintaining the reliability both on a system wide basis and on a local basis. The lesson is that restructuring the market needs an integrated solution and only implementing some aspects of market reform are likely to lead to not achieving the desired objectives.

For example, it is important that if a constrained network will be the basis of transmission planning in the future then the proposed market design needs to accommodate this and discussion can only take place once the implications of this are understood.

Understanding these differences between the markets, the need for a robust mix of market power mitigation measures and the impact the overall reform process is having on the development of new generation within the market will be key to achieving a balanced outcome.

In order to achieve this balance, it is Tersum's view, representation from new market participants should be strongly considered for inclusion within the proposed industry working group.

Conclusion

Tersum supports both the proposed transitional arrangements and the capacity auction. Experience in other markets demonstrates that it is important that an integrated solution be developed particularly with respect to the capacity auction. Potentially, there is a risk that there will be no improvement in either the cost or reliability of the system and unintended consequences. To this end Tersum is prepared to get actively involved to represent new investment in to the WA electricity market and to share its experiences elsewhere.

Should you have any queries please contact Rod Littlejohn – Managing Director via telephone on 0407 579 663 or email rlittlejohn@tersumenergy.com

Yours Sincerely,

Rod Littlejohn
Managing Director