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The Wholesale Electricity Market Investment Certainty Review (Initiatives 1 and 2)

The Australian Energy Council (the "**AEC**") welcomes the opportunity to make a submission on *The Wholesale Electricity Market Investment Certainty Review (Initiatives 1 and 2)* ("**Consultation Paper**") published by Energy Policy WA ("**EPWA**").[1]

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. Our members collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to millions of homes and businesses, and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035, and is part of the Australian Climate Roundtable promoting climate ambition.

Background

The AEC commends EPWA for conducting the Wholesale Electricity Market ("**WEM**") Investment Certainty Review and coordinating the WEM Investment Certainty Review Working Group. Investment certainty and revenue adequacy is an important topic in light of the energy transition underway in Western Australia. The existing generation fleet in the WEM does not appear to match current requirements. On top of this, the State Government has put forward a range of commitments and proposed policies that will transition the energy sector towards more intermittent and low-emissions capacity.

The electricity sector needs to transition quickly and to facilitate this adequate revenue must be available to keep existing generators in the market and incentivise new investment in intermittent and dispatchable generation to maintain future reliability. Failing to do so will have significant consequences, including not being able to meet the WEM objective of reliable supply of electricity at the lowest sustainable cost to consumers.

The AEC considered the issue of revenue sufficiency and investor signalling in 2021 and engaged Marsden Jacob Associates ("**MJA**") to prepare a report that assessed whether the WEM provides revenue adequacy for generators and to recommend measures to enhance revenue adequacy and minimise investor uncertainty. The AEC will draw on the MJA report and member feedback to inform our below comments on the Consultation Paper.

[1] See The Wholesale Electricity Market Investment Certainty Review (Initiatives 1 and 2)

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Proposal 1-4: Reserve Capacity Price curve

The AEC supports the proposal for the price ceiling, deadband, and price floor for the Peak Reserve Capacity Price ("**RCP**") curve. The price floor promotes investor certainty and assists with revenue adequacy and this measure is welcomed.

The AEC does note, however, that at the price floor customers may be paying fees that are not necessary. In circumstances where there is an oversupply and the RCP has hit the floor, AEMO should be signaled to stop investment in Demand Side Management (DSM) during periods of significant excess capacity. In these circumstances, DSM provides limited, if any, additional supply security value to customers. The valuable savings from avoiding Demand Side Management could be passed through to customers who are already experiencing a market of ever-increasing fees.

Proposal 7: Transitional pricing arrangements

The AEC supports this proposal.

Proposal 8-10: Ten-year Reserve Capacity Price guarantee for new technologies

The Economic Regulation Authority ("**ERA**") engaged FTI Consulting to inform its *Triennial review of the effectiveness of the Wholesale Electricity Market 2022*.[2] FTI Consulting points out in its paper that investors require certainty and "to invest in long-life, long lead-time assets, there needs to be clear and reliable revenue opportunities to produce a strong business case for investment."[3] However, the volatility in the current RCP does not support long term investment in flexible generation and storage facilities, and it is unlikely that a 5-year fixed capacity price will be enough to underwrite investment in new flexible generation and storage in the WEM.[4] FTI Consulting notes that:

> *"Offering 15-year contract lengths provides significant benefits to the market, including securing a lower cost of capital that helps reduce the cost of securing required capacity in the WEM and helps reduce market concentration in the WEM."*[5]

MJA also highlights similar benefits with longer term capacity contracts:

> *"Offering 15-year contract lengths provides significant benefits to the market:*
>
> - *Investors will be able to secure a lower cost of capital that helps reduce the cost of securing required capacity in the WEM.*
> - *Long term capacity contracts will support merchant plant entry into the SWIS and help reduce market concentration in the WEM.*
> - *Long term capacity contracts reduce barriers of entry to the WEM by eliminating some complexity of the market mechanisms."*[6]

There is also a precedent for such longer-term contracts, with the UK Capacity Market offering 15-year contracts and the I-SEM in Ireland providing 10-year contracts. The Capacity Investment Scheme in Western Australia also has contract terms of up to 15 years.

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[2] See Triennial review of the effectiveness of the Wholesale Electricity Market 2022: Discussion paper
[3] See p142, Triennial review of the effectiveness of the Wholesale Electricity Market 2022: Discussion paper
[4] See p12, Revenue adequacy for generators in the WEM
[5] See p147, Triennial review of the effectiveness of the Wholesale Electricity Market 2022: Discussion paper
[6] See p81, Revenue adequacy for generators in the WEM

For this reason, the AEC broadly supports a longer fixed price option and it goes some way to assisting investors in underwriting the new flexible firming services. Having said that, the AEC is concerned that the proposal may:

1. **Have limited use** – The AEC notes that facilities requesting the ten-year fixed RCP need to provide evidence that it can provide firm output for at least 120% of the prevailing ESR Duration Requirement.[7] This requirement means that very few new firming services would meet the criteria to receive a 10-year RCP guarantee given the economics of long-duration storage remains challenging. In the current environment, a 10-year RCP guarantee could be created and attract little take-up because investors simply cannot make a sufficient return on firming services that have at least 120% of the prevailing ESR Duration Requirement.

2. **Not be used by generators** – The AEC understands that for a new facility seeking the 10-year RCP guarantee, the prevailing RCP for the current Reserve Capacity Cycle would be fixed as the Facility RCP for the current and subsequent nine Reserve Capacity Cycles. This creates a genuine risk that a new flexible firming service may not receive any capacity credit payments at all if there is not a shortfall of supply in the year the facility is applying. It also creates a perverse incentive for generators to withhold entry into the market until this is a shortfall so as to lock-in a high RCP for 10-years. The AEC encourages EPWA to further consider this issue. One option to avoid these issues is for the new flexible firming service to have a window of time in which can a facility can apply for a 10-year RCP guarantee (for example, two or three capacity cycles).

3. **Exacerbate the problem it is trying to solve** – There is a lack of clarity in the Consultation Paper, however in some sections it appears that only flexible firming services using renewable energy sources (including wind and solar facilities holding Flexible Capacity Credits) will be eligible for a RCP fixed for ten years.[8] The AEC considers this to mean that the flexible firming services would need an agreement with a renewable facility, such as a Power Purchase Agreement. Requiring a new flexible firming service to be supported by a renewable facility appears to be counterintuitive; flexible firming services are needed to maintain reliability in part because new intermittent renewable facilities are quickly entering the market, and linking the two increases the need for more intermittent renewable facilities thereby creating even more reliability problems. The AEC suggests that EPWA should take a neutral approach to how flexible firming services are charged, as is the case in the design of the Capacity Investment Scheme for dispatachable generation, and not require an agreement with a renewable facility.

Conclusion

The AEC appreciates this opportunity to provide feedback on the Consultation Paper and encourages EPWA to consider the issues raised above.

Please do not hesitate to contact Graham Pearson, Western Australia Policy Manager by email on graham.pearson@energycouncil.com.au or by telephone on 0455 233 346 should you wish to discuss this further.

Yours sincerely,

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[7] See p27, The Wholesale Electricity Market Investment Certainty Review (Initiatives 1 and 2)
[8] See p26, The Wholesale Electricity Market Investment Certainty Review (Initiatives 1 and 2)