



Delta Electricity's Response to Capacity Mechanism High-level Design Paper

Delta Electricity (Delta) welcomes the opportunity to respond to the Energy Security Board's (ESB) capacity mechanism high-level design paper and acknowledges the complexity and wide-ranging issues the ESB has considered.

The ESB's high-level design has a number of similarities to Delta's proposed capacity mechanism model. These similarities include:

- existing and new generation capacity should be included;
- a centralised approach to forecasting capacity requirements and purchasing what is required; and
- new and existing investment requirements are different and longer-term capacity contracts should be considered for new investment.

Delta continues to support these design features.

Delta notes that the ESB provided some feedback to the Technical Working Group (TWG) on the industry proposed models. Delta considers it would be valuable to include this in the detailed design paper to provide transparency on how the industry models were considered as there is limited assessment of the industry models within the high-level design paper. One main point of difference between Delta's proposed model and the ESB's high-level design is that Delta's model would only be triggered when reliability shortfalls are identified. This design feature was to:

- minimise the burden and complexity placed on the market but still give confidence to jurisdictions that capacity would be procured when it is needed; and
- allow the spot market to remain the primary driver for new capacity and the capacity mechanism would act as insurance against the market not providing the right capacity at the right time.

Delta notes the ESB's desire to minimise regulatory and administrative burden and suggests the ESB consider this aspect of Delta's proposed model for the next stage of the design. If the ESB decided to go forward with a capacity market, Delta supports:

- a technology neutral design which includes conventional generators;
- a Market Price Cap (MPC) that remains unchanged so that the energy market's spot price continues to be the primary investment signal; and
- minimal performance and compliance obligations to ensure administrative costs are not burdensome.



Eligibility and technology neutrality

Delta agrees that both new and existing generation should be able to participate in the capacity market. This approach would recognise and value the benefit existing generation provides to the market. This would allow access to the most efficient mix of resources to deliver reliability and avoid over-building new capacity before it is required.

Importantly, allowing existing conventional synchronous generators to participate will be critical to discouraging premature exit of existing capacity and essential system service providers before alternative resources are in place. This is a concern Delta has expressed in relation to the speed of transition projected in AEMO's 2022 ISP and acknowledged in AEMO Engineering framework.

Delta echoes the view expressed in the AEC's submission that the capacity market should not be used as an environmental instrument. The capacity market should be a framework to ensure system capacity and achieving the right mix of technologies to achieve the necessary level of system security services. The capacity market should be agnostic of the technology that delivers the capacity and system services.

Market Price Cap

The ESB is considering the level of the MPC and if it should be reduced under a capacity market.

Delta's proposed model of a capacity mechanism did not propose any change to the MPC, as it would be a mechanism that needs to be triggered to be in effect (it may not be in effect for most of the time). The MPC would still be the primary signal for investment with a capacity mechanism only used as insurance against when the market does not provide the right capacity at the right time.

If the ESB continues to prefer and develop a capacity market, it is not necessarily the case that the MPC needs to reduce. This is because:

- Historically, energy and capacity were one in the same as all generators with scale were dispatchable. Now that most of the new generation is not firm or fully dispatchable, a new capacity service is deemed to be needed. This should be seen as an additional service on top of energy, much like how the AEMC is approaching, the operational security mechanism and the soon to be initiated inertia rule change. The latter is a rule change to consider the AEC's proposal to introduce an inertia spot market. This would provide an additional revenue stream for generators who can provide an inertia service.

Delta suggests the ESB considers providing capacity as an additional service, that could be valued similarly to how the AEMC is approaching unbundling and valuing of inertia and other essential system services.

- It is not reasonable or efficient for excluded generation to be subject to a lower MPC. This would distort market signals resulting in the dispatch of less efficient generation first. The ESB needs to consider how large thermal generators' capacity, which is still critical to a secure power system, is valued if jurisdictions decide to exclude them from participating in the capacity market.



Obligations and compliance

The ESB presented three options:

Option 1 – performance obligations based on a capacity provider’s expected availability during time-based performance windows as determined by AEMO.

Option 2 – performance obligations based on a capacity provider’s exposure to spot prices above a certain threshold that can be triggered at any time (such as reliability options)

Option 3 – performance obligations based on a capacity provider’s availability throughout the year plus additional obligations/incentives during actual lack of reserve events, which can be triggered at any time.

Delta supports Option 3 as it:

- has minimal disruption to existing spot incentives and additional incentives from bidding availability create a strong driver to generate at key times; and
- leverages spot incentives with an added driver to bid available into the market at times of stress.

Delta also notes Option 3 should have the smallest impact on contract market operation of the options considered.

Regarding Option 3, the ESB has sought feedback on the weighting between capacity payments for availability throughout the year and availability during periods of system stress, or if capacity payments should only be paid on availability during periods of system stress.

Delta considers:

- a smaller portion of the capacity payment should be based on availability throughout the year as this would provide some revenue certainty for new entrants; and
- capacity payments should be weighted more heavily towards availability during periods of system stress as this would:
 - provide better signals and rewards to capacity providers; and
 - minimise cross-subsidies to those who do not provide capacity.

This means consumers would be paying less for underperforming capacity providers who do not contribute to reliability.

In terms of quantifying the weightings of capacity payments for availability throughout the year and availability during periods of system stress, this will require modelling with fewer unknowns than is currently the case. These weightings may also be influenced by the total value of the capacity payment which is yet to be determined. Delta does consider that more than 50% of the capacity payment should be allocated to availability during periods of system stress, and this could even be higher depending on the total value of the capacity payment and the strength of the compliance regime.

Regarding Options 1 and 2, Delta does not support either at this stage.

Option 1 does not directly account for and reward performance in unplanned system stress outside of pre-specified time windows, does not require actual contribution to reliability, and capacity providers may be paid regardless of their contribution to reliability events.



Delta considers Option 2 creates strong signals for generators to be available when reliability is a concern and provides rewards for firm dispatch during these times. However, Delta acknowledges the concerns raised by the ESB. In particular, the unknown magnitude of impact on risk management and contracts market and that this type of design has only been used in markets without a highly liquid market to manage risk. Delta understands the ESB is unlikely to further consider Option 2 but if it does it should carefully consider the risk to the contract market and possible mitigation.

Compliance

In the context of Option 3, Delta understands the ESB's preference is to not have a rigorous compliance regimen due to the complexity and administrative burden this creates. If the ESB leans towards a material weighting of the capacity payments for year-round availability, then Delta considers a stricter compliance regime will likely be needed to ensure the right 'carrot vs stick' approach incentivises capacity to be available when its needed. However, if the ESB distributes the bulk of the capacity payment towards availability during periods of system stress Delta considers a more 'light-touch' compliance regime would be appropriate.

To discuss the above further please contact Joel Aulbury, Manager Regulation and Strategy, at joel.aulbury@de.com.au.

Yours sincerely

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