Friday, 29 January 2016

Issued by email only

Electricity Market Review Team
Department of Finance
Via email: electricitymarketreview@finance.wa.gov.au

Re: RESERVE CAPACITY MECHANISM REFORMS

Dear Electricity Market Review Team,

Phoenix Energy is developing Australia's first large scale waste to energy plant in the Kwinana Industrial Area; a project with significant environmental, energy security, landfill diversion and economic benefits to the state of Western Australia. The project has been assigned Level 2 status by the Department of State Development.

As a registered wholesale electricity market participant with a new generating facility under development, Phoenix Energy welcomes the opportunity to comment on the impact of the reform process on new more efficient energy generation entering the market.

Encouragement for future entrants

The proposed reform initiatives are intended to reduce the amount of excess capacity in the market with the expected benefit of reducing the cost to electricity consumers of supporting this capacity.

A reform mechanism that introduces any barriers to new entrants will ensconce existing generation and prevent the displacement of less efficient (from economic and environmental aspects) generators. ***We support that the proposed reforms do not intend to introduce barriers to new entrants.***

New projects are subject to investor assessment of the risks to the project. Project financiers require certainty of revenue in order to commit to the project. The lead time for construction of generation projects is in the order of three years. Allocation of capacity credits (via administrative procedure or via auction) needs to be three years in advance of the year the capacity is required in order to secure the finance for a project to proceed. ***We support the proposal to increase the capacity cycle to 3 years forward.***

Removal of existing generation capacity

The move from an administered price for reserve capacity to a market driven (via auction) price, will take some years to occur under the current proposal unless some significant existing capacity is retired from the market. There may be some ownership changes of high operating cost generation as a consequence of the reduced capacity prices, with new owners valuing the assets at a written down value based on the current income from capacity credits. Unless the capacity is retired there will be little impact on the excess capacity in the market. There will need to be retirement of publicly owned assets in order to achieve the outcomes that are desired from this reform process. This will require a direction from government to retire some of Synergy's assets. The earlier this direction is announced, the greater certainty will occur in the market and hence greater stability of prices. ***We support the modelled scenarios of removal of large scale inefficient generation from the market and would like to see strong direction from the government to indicate when this will occur.***

Renewable Energy Target

The renewable energy target scheme is a federal government initiative to increase the quantity of renewable energy in the electricity market via incentives to install and operate renewable energy generation sources. This scheme is counter to the proposed reforms which are intended to remove capacity. The reforms proposed are not intended to discriminate against, or for, any particular technology. An argument has been made that this additional renewable energy capacity is not a significant contributor to the capacity market due to the discounted capacity credits allocated to intermittent generation. Not all renewable energy is intermittent and hence modelling should allow for some of this expected new capacity and also to take into account the continued trend of more energy efficient consumption. ***We recommend that the capacity curve models include increased contribution from renewable energy.***

Energy Prices

Although it has been stated that energy prices will not change due to market participants being restricted to bid energy at the short run marginal cost, it is believed that many participants are currently pricing energy on the basis of receiving capacity credit payments and hence will increase their energy prices to compensate for the reduction in those payments. ***We believe that energy market prices will increase to compensate for reduced capacity payments and hence these reforms may not deliver the expected reductions in electricity cost to consumers.***

US experience of Capacity Auctions

Phoenix Energy's Project Partner, Covanta Energy, a US based Energy from Waste company, have provided the following feedback on their experience with capacity auctions which supports that auctions can be an effective market mechanism:

1. Capacity auction mechanism, if implemented appropriately, has shown to be effective mechanism to rationalize supply and demand.
2. Companies with market power/dominant capacity position, should be subject to price offer cap. The cap should be considered carefully and should be viewed as discount to clearing capacity price.
3. Generator should have the ability to offer several tranches of their unit/system capacity at different prices. This will permit the generator to strike a balance between amount offered for sale, expected price and investment required to sustain reliable capacity supply under various capacity commitment levels.

Yours Sincerely,

Peter Dyson
Managing Director
Phoenix Energy Australia Pty Ltd