



NewGen Power

NewGen Power Kwinana Pty Ltd  
ABN 52 116 827 546  
As Agent for NewGen Power Kwinana Partnership

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Dr Ray Challen  
Steering Committee Chairman  
Electricity Market Review (Phase 2)  
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Dear Dr Challen

## **RESPONSE TO POSITION PAPER ON REFORMS TO THE RESERVE CAPACITY MECHANISM (RCM)**

### **Summary**

NewGen Power Kwinana (NPK) thanks the Steering Committee for providing the opportunity to comment on the "Position Paper on Reforms to the Reserve Capacity Mechanism".

The NPK project participates in the WEM by owning and operating a 328MW combined cycle power station with long term off-take and fuel supply contracts. The project is owned by a partnership between Sumitomo Corporation and Infrastructure Capital Group.

NPK's shareholders made significant investments in the WEM with the support of long term contracts but also with an expectation that the business will operate in a stable and effective regulatory environment. It is therefore important that the RCM reforms deliver solutions which achieve the published Market Review Objectives whilst also supporting the expectations NPK's shareholders had when committing to invest in the WEM.

NPK is supportive of the changes proposed for the transition period and notes that these changes are materially in line with the Reserve Capacity Mechanism Working Group which was subject to significant consultation. With regards to Reserve Capacity Refund Recycling, NPK proposes that an arrangement where allocation is made to generation operating at the time of the forced outage event will better serve market objectives by incentivising generation to enter the dispatch pool by reducing pricing.

With regards to the proposed replacement of the Transition Arrangement with an Auction, NPK supports the principle of a market based outcome for determining pricing, however, it is not possible to support the auction proposal at this stage without having detail on (to list a few): How the auction will work? What limits will be placed on pricing? How will market power be managed? A critical part of this step to a market based outcome is industry consultation and NPK looks forward to the Steering Committee's extensive engagement.



## 1. The Transition Arrangement

NPK is supportive of the proposal to apply the Lantau curve with a slope of negative five to calculation the Reserve Capacity Price (RCP). However, NPK's considers that WEM market participants are likely to require a longer time period<sup>1</sup> to adjust their business models so that the desired target of 5%-6% excess capacity can be achieved without compromising the viability of the businesses. As such, NPK proposes a transition period of at least five years.

NPK supports setting the Lantau curve capacity price cap to 110% of the MRCP as the value of capacity should increase rapidly when there is zero excess capacity or a shortage. This would provide an appropriate price signal to introduce capacity as required.

NPK is also supportive of the transition DSM arrangement. NPK considers pricing the DSM and generation capacities on different basis aligns the market design with the fact the DSM and generation capacities: (a) are fundamentally different (b) have very different cost drivers and (c) are not mutually substitutable. As such, NPK considers the proposed DSM pricing methodology is likely to enhance the price signal to give an adequate mix of generation and DSM capacity investments in the WEM.

NPK also proposes that the Steering Committee considers maintaining the transition arrangement unless the benefits of the proposed auction model compared to the transition arrangement are clearly established.

## 2. Dynamic Refund Arrangement

NPK supports the Steering Committee's proposal to introduce the dynamic refund arrangement. NPK considers a dynamic refund mechanism is likely to improve the valuing of capacity available to the market in accordance with the need of the system. This addresses the current issue of weak alignment between the value of capacity available to the market and the prevailing power system conditions.

## 3. Refund Recycling to Generators

NPK supports the proposal to distribute the Reserve Capacity Refund revenue to capacity providers rather than capacity users.

However, NPK proposes that the refunds should be distributed on an operational as opposed to availability basis. This allocation will incentivise Market Generators to compete for dispatch priority in the BMO resulting in overall reduction in wholesale spot pricing and increased reliability of the power system.

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<sup>1</sup> Scenarios of required time periods are illustrated in Table 4.2 of the Position Paper.



#### 4. The Auction Model

NPK notes that the proposal for generation and DSM capacities to be priced on the same basis under the auction model. NPK is concerned that this will only bring the WEM back to the condition where the DSM capacity price will become markedly disconnected from its economic value, resulting in distortion of the DSM capacity price signal and once again bring the WEM to the state of excess capacity.

NPK considers that subjecting generation and DSM capacities to a competitive capacity auction does not alter the fact that they are fundamentally different products, have different cost drivers and not mutually substitutable. This means the two products will need to be priced differently, with or without an auction process.

As such, NPK recommends that the proposed transition DSM arrangement (where the DSM and generation capacities are priced on different basis) be maintained on an ongoing basis following the conclusion of the transition period.

In order to make a more informed assessment on the proposed auction model, it is necessary to understand its impacts on the market. NPK considers this is possible only after the detailed design and calibration methodology are known. NPK understands that an industry group is likely to be established for the detailed design and calibration processes and looks forward to participating in these processes in the near future (if the Steering Committee decides to move ahead with introducing the auction model).

Nevertheless, NPK offers some high level comments as follows:

- There appears to be merits in setting the auction price cap high at  $\sim 1.6 \times$  MRCP and NPK agrees with the Position Paper that this price cap should be high enough to provide sufficiently strong investment when the reserve margin becomes tight.
- NPK considers the calibration process should be carried out by an independent body, transparent and open to public consultation (i.e. not a "black box" process).
- The Position Paper states that the annual reconfiguration auction "[given the level of complexity] is not warranted in the Wholesale Electricity Market at this time". NPK sees merits of this auction in promoting the WEM efficiency and therefore proposes that the Steering Committee considers implementing such mechanism as a future enhancement of the model design.



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## 5. Deadline for Introduction of the Capacity Auction

NPK considers that a premature introduction of a capacity auction could cause undesirable disruption to the electricity market (as foreshadowed in the Position Paper).

NPK accepts that a deadline may need to be introduced as a last resort in the event where the transition arrangement (modified as proposed above) is demonstrated to be not meeting the reform objectives. Under this circumstance, in order to avoid the foreshadowed undesirable disruption, we consider it necessary to introduce legislations (which take effect prior to commencement of the auction) to:

- subject the capacity price to a floor; and
- provide the correct economic conditions for the retirement of inefficient/uneconomic plants.

Note that NPK propose a transition period of at least five years in section 1 above.

NPK thanks the Steering Committee for considering its comments and welcomes any feedback or questions.

Yours Sincerely

Andrew Sutherland  
CEO