LGP

Landfill Gas and Power

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Economic Regulation Authority
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Dear Sir / Madam

SUBMISSION ON THE ANNUAL WHOLESALE ELECTRICITY MARKET REPORT DISCUSSION PAPER

Thank you for the opportunity to make a submission in respect of the ERA's Annual Review of the Wholesale Electricity Market (WEM).

Landfill Gas and Power Pty Ltd (LGP) has been a producer of renewable electricity since 1993 and a boutique electricity retailer since the commencement of the deregulated market. We currently produce some 9MW of landfill gas fuelled generation and supply some 70 customers operating 350 loads.

LGP considers that the new market has been extremely successful. In particular, it has delivered some $2 Billion of privately financed and operated generation capacity (2,000MW), thereby permitting the State to deploy its development capital in other areas while retaining its AAA credit rating. The market has also seen the development of effective retail competition via six active retailers. Retail competition has been given further impetus now that regulated tariffs have made significant progress towards cost-reflectivity. That said, we note that the customer churn rate is around 50 per month, which is only 3% of the eligible market per year. While there is still considerable scope for development, the indications are that retail prices will ultimately be capped by market forces rather than set by government.

LGP comments in detail on the matters raised in the Discussion Paper as follows, using the paper's format.

The Authority invites comment on any strategic, policy or high-level issues, including those raised in this Discussion Paper, that are impacting on the effectiveness of the Wholesale Electricity Market in meeting the Wholesale Market Objectives.

Verve Profitability:

LGP acknowledges that the losses made by Verve Energy in recent years were not within Verve's reasonable control, and require external remedy. We consider that the losses arose principally because of single-shot issues in combination with the Netback feature of the Vesting Contract between Synergy and Verve. This contract effectively guarantees the profit of Synergy (and indirectly of Western Power) regardless of losses inherent in the gazetted retail tariffs, and allocates to Verve whatever funds are left after Synergy and Network have

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been paid. Verve's ongoing losses are principally caused by the fact that retail tariffs do not recover costs. LGP is disturbed that Verve is now considered 'profitable' as though a formal subsidy to cover losses is a legitimate income. LGP strongly supports the implementation of cost-reflective gazetted tariffs as soon as possible and considers the current subsidy to be damaging to both the market and the environment.

Notwithstanding our comments on cost reflective tariffs, LGP acknowledges that inequity in the Market Rules of the WEM imposes an unreasonable burden on Verve Energy, and we are committed to participating in the ongoing processes for resolving this.

LGP welcomes the decision not to reintegrate Verve Energy and Synergy, and trusts that this distraction is now permanently concluded.

Cost-reflective gazetted tariffs:

We consider that cost reflectivity would restore Verve Energy's profitability, promote energy efficiency, reduce carbon pollution and encourage retail competition. In particular, we are disturbed that at a time of global focus on reducing carbon emissions, customers are not being provided with price signals to encourage them to eliminate waste. Subsidised prices also serve as a barrier to entry for retailers via indirect State support for the State-owned retailer.

Reserve Capacity Prices:

LGP is deeply concerned about the substantial increase in the 2012/13 Maximum Reserve Capacity Price (MRCP) and its consequences for Capacity Prices. In particular, in the absence of a capacity auction, the MRCP is the basis for an administered Capacity Price which increases the costs of un-contracted retailers and bilaterally contracted generators (via the refund mechanism). We consider that prices have blown out due to an increase in the shared network costs from $10.1 million to $46.8 million – an increase of 360%, which in turn contributes $31,000 per year to the price of capacity. Based on the Reserve Capacity Requirement for the 2010 cycle, this adds around $175 million to the price paid by the market for capacity. As commented below, we consider that shared connection costs should be funded via the network tariffs rather than allocated to new developments.

We note that the MRCP Working Group, of which we are a member, is reviewing this issue and are satisfied that this is the proper venue. That said, the Terms of Reference of the group is limited and we also consider that the relationship between the MRCP and the administered capacity price needs urgent review. In particular, we challenge the appropriateness of the 85% conversion factor and suggest that there should be a stronger link between the level of capacity procured and the price paid for it.

Vesting Contract Review:

LGP notes that the vesting contract is being reviewed. We suggest that this process should be transparent and that Verve should be permitted to retain a proper share of its capacity credits for bilateral sale to third parties. It is especially important that this contract not continue as a hidden means of subsidising the State-owned retailer.

Market Rules Objective 3:

We would welcome recasting Market Objective 3 (MO3) to clarify the intent of the avoidance of discrimination against particular energy options. While MO3 specifically references renewable energy, renewable energy has benefited from positive discrimination in some areas, which was built into the WEM at inception; for example, the allocation of Capacity Credits beyond its actual contribution to Hot Season system capacity. As the penetration of

renewable (intermittent) generators increases, this potentially compromises system reliability and security. It is unclear whether MO 3 supports continuation of this benefit or is a basis for its removal.

Demand Side Management:

LGP supports the participation in the market by Demand Side Management (DSM). However, in common with our views on the allocation of Capacity Credits to intermittent generation (below), we consider that credits should only be assigned to capacity that is dispatchable with high reliability. On this basis, we are concerned that the proof of availability criteria is too liberal for DSM and there is insufficient testing of it.

We note that in the 2011/12 capacity year there is 167MW of certified wind capacity compared with 166MW of DSM. However, there have been Expressions of Interest in the 2012/13 year for a further 58MW of intermittent generators and 228MW of DSM. Assuming the vast majority of intermittent generators are wind, there is potentially 225MW of wind and 394MW of DSM.

While the focus is currently on the assignment of Capacity Credits to intermittent generators, we note that DSM is growing much more rapidly and suggest that its participation should be reviewed.

The Authority invites comment on the effectiveness of the Independent Market Operator, System Management and the Economic Regulation Authority.

LGP is satisfied with the effectiveness of the IMO, System Management and ERA. We note that the WEM is subject to an extraordinary level of development and we welcome the commitment of the IMO and System Management.

The Authority invites comment on the impact of feed-in tariff and renewable energy rebate/buyback schemes, as they relate to the efficiency, reliability and security Objectives of the Wholesale Electricity Market.

LGP supports the principles that:

i) The WEM is a vehicle for the efficient production of electricity irrespective of source;
ii) Renewable Energy Technologies should be supported by transparent subsidies; and
iii) Subsidies should be separate to the WEM.

On this basis, we consider that subsidies should be used to support small-scale solar systems, with the principle issue being their cost-effectiveness and focus on the behaviours they encourage. In respect of the Renewable Energy Buyback scheme and the prospective Feed-in Tariff, we note that a payment is made on the basis of anytime export with no time structure. Consequently, overnight wind production is paid the same rate as peak solar production. In particular, a price in the region of 47c/kWh is paid compared with MCAP prices around 5c/kWh peak and 2c/kWh off peak.

While the small scale of the scheme means that the market impacts are primarily born by Synergy, we perceive that this initiative should be transparently financed by Government rather than indirectly via the WEM or the vesting contract between Verve and Synergy. We are also keen to hear the views of Western Power on the quality of supply impact on local residential feeders of these intermittent systems.

The Authority invites comment on the Reserve Capacity Credit allocation to Intermittent Generators.

LGP supports the IMO's Renewable Energy Generation Working Group, of which we are a member, as being the proper venue for reviewing this issue.

LGP supports the principle that entities be granted capacity certification on the basis of their contribution to the reserve capacity procured to meet the system peak and that this mechanism should not be used as a mechanism to subsidise renewable energy generators. We note the system manager's concerns that "the power system cannot be run on averages" and support discontinuation of the current averaging approach to certifying wind.

The Authority invites comment on the existing and potential impact of intermittent generation on the Wholesale Electricity Market, including the need for cost reflectivity under the existing framework and Market Rules.

LGP acknowledges the considerable impact on the power system posed by increasing penetration of intermittent generation and supports the IMO's Renewable Energy Generation Working Group, of which we are a member, as being the proper venue for this issue.

LGP supports the principle of cost reflectivity of ancillary services and the allocation of these costs to users.

The Authority invites comment on the current framework for network access and the determination of capital contributions for augmentation to the shared transmission network provided by Western Power. In particular:

- **the impact that the current framework has on the effectiveness of the WEM;**
- **the impact on investment decisions, given the level of transparency and predictability in the current network access and connection charging regime; and**
- **the appropriate methodology for recovering transmission augmentation costs triggered by new generation in the South West interconnected system.**

LGP supports the ERA's comment to the effect that the Queuing Rules impose an administrative process as a rationing device, rather than requiring an efficiency framework for assessing new customers. We are concerned about the perception that Western Power seeks to allocate as much cost as possible to a project proponent rather than recover as much as possible from network tariffs. If Western Power was subject to private sector commercial imperatives, it would be keen to connect new generators and loads.

LGP supports the role of the IMO Capacity Certification process as a form of due diligence of proposed power stations and the requirement for network access as a precondition of capacity certification. However, we consider that commercial viability of a development should be the primary hurdle for commitment rather than inability to obtain a network access offer due to low priority in a first-come first-served queue.

We therefore support review of the network access process to this effect.

In particular, LGP is deeply concerned about Western Power's application of shared connection costs to new developments. In addition to the issue of the proportion of the network augmentation that should be allocated to network tariffs, the Queuing Policy requires extensive technical review whenever queue bypass is contemplated. While we acknowledge there is merit in having a location signal via network access for new developments, we consider this to be subsidiary to the merits of a simplified access regime.

We therefore support review of a constrained access model in which the shared augmentation costs are funded via the network tariffs, with the development to bear only the direct connection costs. We note that this would create a capital rationing issue, but consider that this should have regard to projects possessing commercial viability subject to network access.

We note that development of a constrained access model would necessitate a review of the Wholesale Market Rules for dispatch and capacity allocation, which could be complex.

If you require any further information in respect of this submission, please contact Steve Gould, General Manager - Retail on 0412 508 291.

Yours faithfully

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CHIEF EXECUTIVE OFFICER