Wholesale Electricity Market
Rule Change Proposal Submission Form

RC_2012_10 Limits to early entry capacity payments – second round submission

Submitted by

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Submission

1. Please provide your views on the draft report, including any objections or suggested revisions.

Background

The market rules provide what has been referred to as a "reserve capacity window" for new plant. This four month window precedes the period from which reserve capacity obligations are mandated to apply. During the reserve capacity window, newly commissioned plants qualify to receive reserve capacity payments.

By incorporating a four month reserve capacity window the rules recognise that commissioning can often be a complex and extended process for new generating plant before a satisfactory level of reliability can be achieved. During this period new generators work closely with System Management to ensure adequate ancillary services are scheduled to accommodate necessary testing routines so that the system as a whole continues to operate reliably and securely.

At market commencement the reserve capacity window straddled the start of capacity year in October. New plant could commission from as early as August through to as late as November after which mandated reserve capacity obligations applied. Reserve capacity payments in respect of new plant made prior to the start of capacity year are often referred to as "early capacity payments". At market start new plant commissioned from August could receive up to two months of early capacity payments.

Thus allowing access to early capacity payments was designed as an incentive for new plant to commission ahead of the capacity year to provide an extended period to achieve reliability and for System Management to schedule the required testing prior to the peak load season of summer. In effect, it acts as a carrot for new plant to commission early to address the almost inevitable post commissioning issues (especially in respect of large thermal plant) and is complementary to the other potentially more effective incentive to commission before mandated reserve capacity obligations apply, which is the avoidance of reserve capacity refunds. The latter is considered to be more effective because it imposes a refund obligation that reduces the net cash retained from the guaranteed reserve capacity payments (payable when mandatory reserve capacity obligations take effect), whereas access to early capacity payments was never guaranteed: it was always dependent on commissioning being achieved prior to mandated reserve capacity obligations taking effect.

Following the late arrival of some large capacity plant that coincided with a period characterised by a tighter capacity supply and demand balance and the subsequent initiation of the Supplementary Reserve Capacity (SRC) process by the IMO, rule change RC_2009_11 was promulgated. RC_2009_11 brought forward the reserve capacity window by two months to commence in June and mandated reserve capacity obligations were correspondingly brought forward to coincide with the start of capacity year in October. Newly commissioning plant taking advantage of the reserve capacity window now has access to up to four months of early capacity payments.

At that time, the market judged that bringing forward the reserve capacity window by two months as well as access to the attendant early capacity payments was a reasonable additional impost on the market as it reduced the risk of late arrival and commissioning periods extending into the summer peak period. This in turn reduced the risk of the IMO stepping in an initiating a SRC auction to procure some replacement capacity to safeguard system reliability and security through the coming summer peak period. In effect, the change increased the insurance premium paid by customers (i.e. early capacity payments now available for four months) to protect them from new plant failing to meet their obligations to commission and be available at the time mandatory reserve capacity obligations take effect.

Since then, the combination of excess capacity compounding at 90% per annum to 775 MW over the three years to 2013/14 together with DSP capacity increasing by 325% to 500 MW over the same period provided, in Synergy's view, an impetus for a review of the reserve capacity window arrangements and in particular whether it could be amended to reduce the cost borne by customers without adversely impacting its intended objectives.

RC_2012_10 – Synergy proposal

Synergy submitted the above rule change at the June 2012 MAC meeting for consideration; the MAC supported the proposal entering the formal rule change process.

In preparing its proposed rule change submission and bearing in mind the discussion points raised by Alinta's somewhat similar 2010 pre-rule change proposal, Synergy sought legal advice to assist it in interpreting the concept of discrimination in the context of market objective (c). The advice was circulated to MAC members and in brief concluded:

(i) It is consistent with the market objectives and operation of the rules to treat Scheduled Generators and Non-Scheduled Generators differently from other

Facilities where different treatment is based on fundamental differences in the characteristics of those Facilities; and further that

(ii) In the absence of determinant criteria in the rules with regard to matters of discrimination, a review of case law distinguished the concept of indirect discrimination and in applying this concept to current arrangements under the rules it was concluded that there was a good argument that the proposed rule change would address the indirect discrimination against Scheduled Generators and Non-Scheduled Generators in favour of DSPs.

Synergy's proposal was that Facilities other than Scheduled Generators and Non-Scheduled Generators be precluded from accessing early capacity payments. This proposal rested on two propositions:

(i) Firstly, that sufficient technical difference exists between Scheduled Generators and Non-Scheduled Generators, and other Facility types[1] such that implementing the proposal would better achieve all the market objectives (objective (e) excepted – would not be inconsistent with), noting that in regard to market objective (c) it would remove indirect discrimination favouring Facilities other than Scheduled Generators and Non-Scheduled Generators; and

(ii) Secondly, that the focus of RC_2009_11 was on providing additional time for Scheduled Generators and Non-Scheduled Generators to work through their commissioning issues such that they achieved satisfactory reliability levels prior to the summer peak season, reducing the risk of system failing to meet demand putting customers at risk of non-supply. The RC_2009_11 discussion did not extend to consideration of other forms of capacity because such capacity is, in most cases, procured from existing loads and commissioning of the adjunct technology and equipment that gives effect to meeting reserve capacity obligations is a trivial exercise in comparison with that related to commissioning new Scheduled Generators and Non-Scheduled Generators, leading to the conclusion that access to an extended reserve capacity window is unnecessary for the other forms of capacity. Thus it was an unintended outcome of RC_2009_11 that it also applies to such other forms of capacity and that this oversight in the rules exposes customers to potential additional cost without commensurate benefit. [2].

RC_2012_10 - Market response

The majority of the six submissions (excluding Synergy's) made in the first submission period supported the proposed rule change agreeing that the commissioning requirements of Facilities other than Scheduled Generators and Non-Scheduled Generators were less complex and would not pose a threat to summer peak reliability and therefore were not in need of an incentive to commission prior to the start of the capacity year.

[1] In RC_2012_10, Synergy enumerated a range of circumstances where the rules allow for different performance standards and accommodate different requirements dependent on the technology underpinning the capacity.

[2] The recent work done by the Lantau Group assessed the value to customers of excess capacity at less than $1,000 per MW, far less than the Reserve Capacity Price. In this context, when such capacity is commissioned ahead of the reserve capacity year for which it was certified, it imposes additional costs on customers for negligible benefit.

It is noteworthy that two of the respondents concurred with the view that RC_2009_11 was, given the experience with the delayed arrival of the Bluewaters plant, targeted at generation capacity and that its application to DSM capacity was the result of an oversight.

Draft rule change report – IMO assessment

In assessing rule change proposals the IMO must ensure that they are consistent with the market objectives and have regard to the items listed in clause 2.4.3, one of which is that it must have regard for the views expressed in the rule change submissions.

In light of these requirements, the IMO assessed the rule change proposal as being inconsistent with the market objectives, arriving at this view by concluding that the inconsistency of the proposal with market objective (c) outweighed what it considered to be potential benefits flowing from the proposal consistent with market objectives (a) and (d). In particular, the IMO expressed the view that the cost and efficiency benefits arising from the proposal could not be achieved without "targeting"[3] a specific type of capacity.

In arriving at its view in regard to market objective (c), Synergy summarises the IMO's key discussion points and interpretations as:

(i) Treating different facility types differently is not discriminatory where it is necessary due to technical characteristics;
(ii) There is no evidence supporting the removal of early capacity payments to DSPs is necessary on technical grounds;
(iii) Where different treatment is permissible on other than technical grounds it is not discriminatory if no facility type is disadvantaged or denied opportunity but as the proposal disadvantages DSP capacity it is, by extension, discriminatory; and
(iv) Synergy's legal advice notes a number of differences between generating facilities and DSPs and suggests uniform access to reserve capacity payments may amount to indirect discrimination. The IMO suggested that the advice does not then go on to explain how these differences distinguish the value of early capacity[4] provided by a DSP from that provided by a generator with regard to reducing summer peak reliability levels, potentially requiring the IMO to initiate a SRC event.

The IMO concluded that it is difficult to construe that access to the same payment for providing the same service constitutes indirect discrimination that favours DSPs in comparison with generators and it consequently determined that the proposal discriminates against DSPs and has a strong negative impact on market objective (c).

In regard to market objective (d) the IMO acknowledged that precluding DSPs from early capacity payments would reduce costs, but that this benefit would need to be balanced against the increased risk of these savings being less than costs arising from the IMO's decision to initiate a SRC event if a shortfall were to subsequently occur.

[3] The IMO did not further elucidate the meaning of this word in this context although Synergy notes that markets are relentless in their drive for efficiencies and this necessarily results in adjustments between the relative economic positioning of and returns to different technologies.
4 Here the context is the commissioning of capacity during the reserve capacity window.

Synergy's response
Synergy does not agree with the IMO's assessment that the proposal is inconsistent with market objective (c) and in any event that it is of such a material nature that it more than offsets the benefits to customers evident through the proposal better achieving market objectives (a), (b) and (d).

Synergy contends that the IMO has misinterpreted Synergy's legal advice with regard to indirect discrimination and its application to the proposal. The advice supports the proposition that treating capacity technologies the same, which in the context of the proposal is taken to mean access to early capacity payments, represents indirect discrimination favouring one group of capacity technologies, i.e. load based capacity over generation technology based capacity.

Synergy notes that the IMO, in its assessment, states that the legal advice does not, in the context of the listed different treatment of technologies, distinguish a value difference between the technologies in providing timely capacity. Synergy holds that this is an incorrect interpretation of the purpose of the advice: it did not seek to draw such a distinction as related to differing capacity technologies in regard to providing a reserve capacity service, rather it defined the nature of indirect discrimination and in treating sufficiently different technologies the same an argument could be made that to do so would amount to indirect discrimination.

Synergy maintains, noting some other market participants are of similar views, that the technical characteristics of the technologies (i.e. load based capacity and generation based capacity) are sufficiently different to support the proposition that it is both appropriate and efficient to differentiate access to early capacity payments.

It is appropriate because the DSP commissioning process deals with communication and load control technologies for existing loads whereas the commissioning process for new generation plant deals with the integration of a large range of technologies and processes that typically result in an extended fault resolution period post commissioning. Synergy maintains that these technical differences resolve to markedly different risk profiles – this is further explored below - in regard to the extent that they can impact system reliability and security during the summer peak season and therefore the need to initiate a SRC event. In short, a four month reserve capacity window is considered not to be required for new load based capacity.

It is efficient because precluding new load based capacity's access to early capacity payments reduces excess capacity costs imposed on customers in the preceding year noting that the value of excess capacity to customers is negligible. Further, the insurance premium inherent in early capacity payments made to new load based capacity is not justified given the different risk profile such capacity presents to the system.

Synergy agrees with the IMO's position that prolonged delays in attaining commercial operation and therefore commissioned status by new generation capacity may require the IMO to step in and initiate a SRC. However, Synergy does not support the proposition that this conclusion equally applies to DSP capacity. This is because typically a DSP is comprised of a number of associated loads[5] of which the aggregator will seek to commission as many as possible prior to mandatory reserve capacity obligations taking effect in order to minimise revenues lost through being exposed to reserve capacity refunds. The diversification inherent in DSP capacity thus presents a different and lower risk to system reliability and security when compared to a generator of equivalent capacity and therefore does not present an equivalent risk in respect to the need for initiating an SRC event.

Synergy contends that the purpose of the proposal is not to target any particular form of technology per se but rather to propose, given the understanding of indirect discrimination as set out in the legal advice, that the technical differences between the load based and generation based capacity are sufficient that it would not be discriminatory to remove access to early capacity payment incentives by load based capacities which would thereby improve market efficiencies and reduce excess capacity costs imposed on customers.

2. Please provide an assessment whether the change will better facilitate the achievement of the Market Objectives.

Synergy's assessment remains as provided in its rule change proposal.

3. Please indicate if the proposed change will have any implications for your organisation (for example changes to your IT or business systems) and any costs involved in implementing these changes.

Synergy notes that the proposed change will have negligible impact on its business or IT systems.

4. Please indicate the time required for your organisation to implement the change, should it be accepted as proposed.

Synergy could implement this proposed rule change immediately.

[5] In circumstances where a DSP comprised a single operating load, because commissioning of the associated communication and load control technology is trivial in comparison with the complete commissioning process for new generators, it is difficult to see that commissioning issues for a single load DSP, given the incentive to avoid reserve capacity refunds, would extend into the summer peak period or that the individual load's capacity would be of such magnitude that its inability to meet its reserve capacity obligations in full would threaten system reliability and security to the extent that it would be necessary to initiate an SRC event.