
**Wholesale Electricity Market
Rule Change Submission Form****RC_2013_10 Harmonisation of Supply-Side and Demand-Side
Capacity Resources**

Submitted by

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Submission

1. Please provide your views on the proposal, including any objections or suggested revisions.***Background***

There have been concerns raised within industry and government for a number of years around the fact that despite providing the same role in meeting peak demand requirements and being rewarded similarly, capacity resources are not always treated consistently in the Wholesale Electricity Market (WEM).

Consistent with these views the recent review of the Reserve Capacity Mechanism (RCM) by the Lantau Group identified a number of issues with the existing performance requirements for Reserve Capacity including:

- *The role of Demand Side Management (DSM) in the RCM* – The Lantau Group suggested harmonising the treatment of demand-side and supply-side (generation resources) by increasing the minimum availability requirement for Demand Side Programmes (DSP).
- *The fuel requirements imposed on generation capacity providers* – The Lantau Group suggests refinement of the fuel supply requirement.

To consider those issues raised, and recommendations made, by the Lantau Group, the IMO constituted the RCM Working Group (RCMWG) in early 2012.

RCMWG's deliberations

To assist in the RCMWG's deliberations on those recommendations relating to the harmonisation of capacity resources (Work Stream 2), the IMO engaged Dr Richard Tooth from the Sapere Research Group.

Dr Tooth provided the following high level observations which consequently formed the basis of the proposed changes put forward to the RCMWG's consideration:

- Fuel Requirements (Issue 1)
 - There are sufficient commercial incentives in the energy market for base-load and mid-merit generators to meet demand outside of Peak Trading Intervals. As a result, the role of performance requirements is around ensuring generators can meet the incremental energy requirements during the daily peak.
 - Generally commercial incentives along with those incentives provided by the energy market and capacity refunds will ensure that there is reliable supply during peak periods. However these may be insufficient for some high-cost generators who infrequently participate in the energy market (i.e. low profit contribution) under the current market design.
 - Changes to implement dynamic capacity refunds would create greater commercial incentives for high-cost generators to ensure they have sourced sufficient fuel, thereby potentially enabling the current prescriptive fuel requirements to be removed from the rules.
- DSM – Harmonisation (Issue 2)
 - All capacity resources and availability classes are treated equally under the current design. That is, DSM capacity is valued the same as generation capacity¹.
 - Despite the requirement that all capacity is treated the same, there is a significant divergence between the performance requirements for DSM and Scheduled Generators currently.

Reflective of these underlying considerations in the existing market design the key proposals that were determined to proceed through to the Rule Change Process were to:

- Relax the requirements for facilities to have firm fuel supply contracts in place, provided that the capacity refund mechanism is assessed to provide sufficient commercial incentives for Facilities to be available when required;

¹ Dr Tooth noted that there are a number of advantages and disadvantages in DSM in terms of its contribution to reliability and it would be premature comment on its relative value (refer to page 24 of the combined 17 April 2012 meeting papers).

- Revise the DSM availability requirements, including allowing unlimited dispatch events per year, decreasing the minimum notice period for dispatch and ensuring DSM is available for an unlimited number of hour each year;
- Require all DSP's to provide a telemetry service providing real time information on availability and performance;
- Removing the “third-day rule” – whereby a DSP dispatched for a third continuous day is not subject to capacity refunds;
- Enabling dispatch of DSP's outside of their nominated availability limitations on a best efforts basis; and
- Amend the operation of the Non-Balancing Dispatch Merit Order to be based on time since last dispatch.

It is important to note that the RCMWG was not in unanimous agreement on these proposed changes.

Proposed changes

The IMO proposed a suite of changes to implement the key proposals outlined above with respect to harmonising DSM with generation capacity and to relax the current fuel requirements for Scheduled Generators.

Alinta's views during first round of consultation

Alinta generally supported the proposed changes as representing a significant improvement over the current market design. An overview of Alinta's specific views on each of the proposed amendments follows:

- *Issue 1 - Fuel Requirements:* Alinta supported the principles behind the IMO's proposal to relax the fuel supply arrangements and enable Scheduled Generators to determine how they manage peak energy provision requirements.
- *Issue 2 – Harmonisation of DSM:* While generally supportive of the IMO's proposal to harmonise the treatment of DSM with generation resources, Alinta raised the following points:
 - the changes should be postponed and considered as part of the wider WEM review;
 - a more holistic review of DSM in the market is required, including consideration of differential pricing and the introduction of a dynamic baseline methodology for measuring DSM's performance;
 - the methodology proposed to restrict a DSP from selling more capacity than it buys through IRCR includes an inappropriate artificial inflation through the inclusion of the NTDL and TDL multipliers that should be removed.

Specific details of Alinta's views are outlined in its 3 October 2013 submission available on the IMO's public website.

Draft Rule Change Report

In its Draft Rule Change Report the IMO made minor amendments to the proposed Amending Rules to:

- Ensure that DSM provides pay capacity refunds on any unfilled portion of a DSP (currently a DSP that is not filled for an entire Capacity Year will not fully repay its entire capacity income);
- Clarify that all Non-Balancing Facilities must be covered by Dispatch Advisories; and
- Clarify the existing obligations contained in clauses 4.26.3A, 7.6.10 and Appendix 5

Alinta's views on the Draft Rule Change Report

Alinta continues to generally support the proposed changes as they represent a significant improvement over the current market design.

Alinta also maintains its view that the harmonisation of DSM and generation changes should be postponed and considered as part of the wider WEM review where a more holistic consideration of DSM in the market can be undertaken, including consideration of differential pricing and the introduction of a dynamic baseline methodology for measuring DSM's performance.

However rather than simply reiterating Alinta's views presented previously, this submission provides comment on additional changes made by the IMO in its draft report and additional matters which have come to Alinta's attention since the first round of consultation.

Issue 1: Fuel Requirements

Alinta continues to support the principles behind the IMO's proposal to relax the fuel supply arrangements. However the proposed changes to the rules, when read in conjunction with the proposed amended Market Procedure for Certification of Reserve Capacity (Market Procedure), suggest that the IMO will be adopting a broader approach to considering fuel when assigning Certified Reserve Capacity by removing any reference to the peak capacity period. Alinta notes that neither the proposal nor the draft report stated any rationale for the change in principle from defining the 14 hour primary fuel requirement and 12 hour dual fuel requirement (the current "test"), making it unclear whether the IMO adequately considered the consequences of the proposed amendments.

In a move to address industry concerns that the IMO's proposed complete removal of the current test applied when determining whether a facility will have sufficient fuel would create regulatory uncertainty, the IMO has proposed a new test for certification, as contained within the proposed Market Procedure which was formally submitted during the second consultation period for the rule change. While a step in the right direction, Alinta considers that the new proposed test continues to result in regulatory uncertainty and appears at odds with the

IMO's previous position of providing clear availability requirements so as to ensure facilities do not incur unnecessary costs as a result of unnecessarily onerous fuel requirements².

Alinta's specific comments on the proposed new test follow:

- It is preferable to know in advance the exact information that will be required during the certification processes to prove that a generator has sufficient fuel supply. Under the proposed new test it will be unclear what the exact fuel requirements for a generator in order to be certified would be year on year.
- There is no ability for the relevant generator to provide feedback on the IMO's assessment of the anticipated operational characteristics of that facility during the relevant capacity year. Past behaviour will not always be a good indicator of the expected behaviour of that facility during the relevant Capacity Year and so Alinta considers that generators should be provided with an opportunity to provide evidence that there may be a change in its operational characteristics that should be accounted for by the IMO. Following the IMO Procedure Change and Development Working Group meeting on 6 February 2014, Alinta understands that the IMO will be addressing this issue.
- New entrants, particularly those developing liquid fuel plants, will under the proposed new test have no clarity of their exact requirements when it comes to fuel supply, i.e. how big a tank does it need to build in order to ensure it can receive CRC.
- The proposed new test will potentially result in different fuel requirements applying for various facility types. While this may better reflect the nature of the generation technology, it will introduce a further level of complexity into the market design which Alinta considers has not been adequately considered to date.

More broadly Alinta queries whether it remains necessary for the IMO to consider fuel in making its certification decisions at all. The IMO has formed a view that there are sufficient external drivers for a generator to secure fuel and so it is unclear whether consideration of fuel supply remains relevant for the purposes certification. Alinta suggests that there are significant non-market drivers for most generation to ensure they have appropriate fuel arrangements in place and requests the IMO to consider removing consideration of fuel entirely from their capacity certification decisions.

Should the IMO determine that it is appropriate to continue to account for fuel in making capacity decisions Alinta notes its preference is for the exact fuel requirements to be specified in an appropriate regulatory instrument so as to enable certainty as to what information needs to be provided during certification and ensure unnecessary additional costs are not incurred (which would be contrary to Market Objectives (a) and (d)). However if the IMO determines to continue down the pathway of removing the prescribed hourly fuel requirements for certification then Alinta requests:

- formal confirmation that going forward the fuel requirements will be no higher than those currently prescribed (i.e. 14 hours for primary fuel and 12 hours for dual fuel).

² Alinta notes that concerns around providing clear availability requirements for facilities motivated the IMO's previous changes to better clarify what was meant by peak periods, as progressed by RC_2010_14.

Alinta notes that this will ensure that unnecessary additional costs are not incurred by the market and will act to set a “maximum” fuel requirement for certification – which is particularly important for potential new entrants. Alinta understands that the IMO will be providing this confirmation in the Final Rule Change Report and/or within a comment box in the Market Procedure.

- the principle underpinning the IMO’s fuel assessments for the purposes of certification is outlined in an appropriate regulatory instrument so as to provide certainty to the market of the context for the IMO’s decision making (given that the rules will now remain silent on this matter).

Alinta acknowledges the difficulties faced by the IMO in clarifying that certification decisions relate to a facilities anticipated performance during peak periods – given its difficult to define “peak periods”. However without clarifying that the test relates to peak times (or alternatively periods of low system reserve) there is a risk that in the future a much broader test may be applied, particularly for Baseload generators for which the “expected operational characteristics” would potentially mean they need sufficient evidence of fuel to operate for a significant proportion of the year.

Alinta recommends that a principle along the lines of the following is incorporated: *“In assessing applications for Certification of Reserve Capacity the IMO must take into consideration whether the relevant Facility would be reasonably expected to have fuel available for periods of low system reserve during the relevant Capacity Year.”*

- the IMO outlines how it will apply the new test prescribed in the Market Procedure when assessing fuel for the purposes of certification. For example it is unclear whether the IMO will continue to be interested in whether a facility has a defined number of hours of fuel stock or rather simply that the facility has appropriate arrangements for the supply of fuel in place.

Alinta notes that to the extent that the test is simply that appropriate access to fuel has been arranged it may be appropriate to clarify this when prescribing the principle underpinning the IMO’s assessment of fuel when making certification decisions.

Alinta also offers the following broader comments:

- The changes to clause 4.10.1 will result in information on the processes for changing from one fuel to another needing to be provided during certification. Alinta considers this information is most appropriately provided as Standing Data and notes that no rationale for requiring this information at certification has been outlined.
- Clause 4.10.2 cannot be deleted entirely as proposed but rather needs to be made “blank” so as to not distort the sequence of numbering in the Market Rules.

Issue 2 – Harmonisation of DSM

With respect to the IMO’s proposal to amend clause 4.26.2CA to restrict a DSP from selling more capacity than it buys through IRCR, while supportive of the general concept of introducing a cap on a DSP’s RD to address potential gaming opportunities Alinta does not

support the IMO artificially inflating the IRCR values by the amount of the relevant NTDL and TDL multipliers for the purposes of setting the cap.

Alinta considers that a more appropriate principle that is better aligned with the intention of the certification processes is that *“a DSP should not be able to sell more capacity than its Associated Loads consume during the IRCR intervals (i.e. as reflected by the loads unadjusted IRCR)”*. Application of this principle would ensure that where an Associated Load reduces its consumption so as to reduce its IRCR then it will have little or no ability to provide DSM capacity. However where an Associated Load does have an IRCR then this is a clear indicator that the relevant Load can provide DSM capacity.

Following discussions directly with the IMO, Alinta understands that the intention of using the uplifted IRCR value is to align the commercial outcomes while removing the potential for gaming to occur. The IMO's appears to consider perverse outcomes will occur unless the commercial payment for the capability of reducing the loads consumption (through the capacity market) aligns with the loads commercial liability (the IRCR liability).

Alinta disagrees with the logic being applied by the IMO to set the cap for RD. The proposed cap will potentially bind in some circumstances and therefore set the level of the DSP's RD. For the purposes of certification the only relevant consideration is the loads actual physical capability (not its commercial liability). The IMO does not focus on ensuring the alignment of commercial outcomes for any other facility type when making certification decisions - rather the IMO's focus (quite rightly) is on ensuring the true level of capacity for the Facility is reflected by its CRC.

Alinta considers that enabling a load to fully hedge its IRCR liability would introduce a disjoint between the treatment of DSM and generation capacity. For example, a Market Customer seeking to bilaterally cover its IRCR liabilities for a number of Temperature Dependent Loads would need to enter into an agreement with generation capacity to physically cover the uplifted IRCR level. If the generation only covered the physical level of load consumption the level of certification it would potentially receive would not be uplifted by the relevant TDL ratio. As a result the Market Customer would not be hedged for its uplifted IRCR liabilities (i.e. it would have a shortfall of Capacity Credits) and so would be subject to the Targeted Reserve Capacity Cost³. Enabling a load to be able to have its CC's potentially set at the uplifted IRCR level simply so it could cover its commercial obligations is inconsistent with the treatment of generation.

Alinta recommends that the IMO uses the actual unadjusted IRCR value in setting the cap so as to ensure that a DSP is certified at a level that reflects its physical capability. It is unclear how anything other than reflecting the actual physical capability of the DSP when assigning CRC would be consistent with the Market Objectives, the concept of “harmonisation” embodied in this rule change or and the broader intentions of the capacity mechanism.

If you require any further clarification of the matters raised in this submission please directly contact Fiona Edmonds, Wholesale Regulation Manager.

³ Alinta acknowledges that the where embedded generation is installed to cover a loads IRCR liability the circumstance is different.