Wholesale Electricity Market
Rule Change Submission Form

RC_2013_09 Incentives to Improve Availability of Scheduled Generators

Submitted by

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Submission

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

Background

Since 2006 when the Wholesale Electricity Market (WEM) commenced operation, a number of Scheduled Generators have had relatively high levels of Planned Outages (for which there is no requirement to refund Capacity Credit income) compared to international standards.

Concerns with the low availability of Scheduled Generators have been raised by the Economic Regulation Authority (ERA) and the Independent Market Operator (IMO). In particular, the ERA stated the following in its most recent report to the Minister on the effectiveness of the market:

> *"The Authority is concerned with the high rates of planned outage that have been observed for some Verve Energy plant over consecutive years. These generators received full capacity payments under the current market arrangements, whilst being unavailable for extended periods on planned outage, causing higher prices in the energy market than would otherwise be the case. The Authority considers that this is an inefficient market outcome."*

The IMO considers that a low level of availability of these facilities has had the following implications:

- Poor value for money;
- Inefficiency with respect to market pricing outcomes;
- Higher risk to the system;
- Inequity within facility class;
- Retention of inefficient and unreliable generating plant;
- Misleading capacity supply signals.

These impacts are considered to be inconsistent with the Wholesale Market Objectives of economically efficient, safe and reliable supply of electricity (a), encouraging competition (b), and minimising the long-term cost of electricity to customers (d).

Alinta views on the low levels of availability of Facilities

Alinta agrees with the concern that making equal capacity payments to unreliable generators as is paid to reliable generators is an inefficient outcome for the market. Alinta is of the view that paying for generation according to the value of its capacity is an issue that should be addressed in the Minister's WEM review.

However, Alinta disagrees with the ERA's concerns that higher prices in the energy market during an outage of a facility is in itself an inefficient market outcome that warrants further market intervention. Assuming that the high level of outages for the facilities is legitimately required, the higher prices in the energy market are indicative that the market is working effectively in this circumstance, regardless of the existence of a capacity market. This is because short term increases in energy market prices will potentially signal changes in behaviour from other participants[1]. For example an increase in the energy price may encourage a lower cost generator to become available (i.e. cancel its Planned Outage) so as to either take advantage or the higher prices or reduce its exposure to purchasing any contracted energy at the higher market price. Assuming that given the existence of the capacity market, energy prices shouldn't adjust to signal changes in behaviour is overly simplistic.

Higher prices are also a reflection of the market working effectively in so far as the Balancing Price determined is a direct result of the bid prices of the respective available plant mix and heavily influenced by the type of plant which is on outage. Naturally if there are units with lower operating costs on outage, then the availability of low cost energy during those periods is scarce resulting in facilities which would normally feature higher up in the Balancing Merit Order being required to be dispatched. These facilities would only do so if the resultant Balancing Price is able to at least re-coup their costs of production. Alinta is uncertain whether during the relevant periods when the "excessive outages" took place the liquid price caps were reached, potentially because Verve's low cost plant was still available for dispatch.

Overall, while Alinta agrees with the general policy issue that generators which are unreliable should not receive the same capacity income as those which have a high level of reliability,

[1] Note that rationale investors will not interpret increases in energy prices as a signal for further investment in the WEM given the existence of the capacity market. This differs to the National Electricity Market which signals to investors the need for further generation capacity through price spikes.

we note that the broader issue of appropriately reflecting the value of capacity should be considered via the WEM review. Likewise we are not convinced that an increase in energy prices during the relevant periods is indicative of a need for market intervention in this case. Further details of Alinta's specific views on the Rule Change Proposal follow.

Rule Change Proposal

It has been suggested that the low levels of availability of some plant is reflective of inadequate incentives existing in the current Market Rules for Market Participants to maximise the availability of their Scheduled Generators. The IMO subsequently proposes the following changes to the Market Rules to address the issue:

- Enable the IMO more flexibility in assigning a reduced quantity of Certified Reserve Capacity (CRC) to Scheduled Generators that display excessive outage rates over a 36 month period;
- Impose an upper limit on the number of Trading Intervals in any 36 month period for which a generator can receive a reduction of its Reserve Capacity Obligations Quantities (RCOQ) due to Planned Outages; and
- Provide the IMO with discretion to require performance reports from a Market Participant concerning a Scheduled Generator with an excessive Planned Outage rate, regardless of the availability of total system capacity.

Alinta's views

Alinta does not support the proposed suite of changes.

Notwithstanding there has not been any persuasive evidence presented to industry to justify the broad suite of proposed changes to the Market Rules, Alinta considers that the current Market Rules already provide the IMO an ability to address any concerns around high levels of unavailability and there is unlikely to be a risk to system security. That is:

- The current Market Rules already provide a mechanism for the IMO to not provide any CRC to a Facility which has excessive level of unavailability. This provides a clear signal for the retirement of inefficient plant and addresses any concerns about "value for money" with respect to the provision of capacity. Alinta notes that the relevant facilities that are considered to have experienced excessive rates of outages are Verve's older and potentially less efficient facilities.
- We do not believe there is a risk under the current rules to system security given System Management has a clear role in approving Planned Outages. It is unclear how there could be a higher risk to the system associated with the excessive outage rates of some facilities in the SWIS given that one of the key considerations of System Management in approving Planned Outages is whether there would still be sufficient margin available to ensure system security can be maintained. Therefore it could be argued that the excessive outage rates of some facilities in the SWIS are in part a symptom of the current oversupply of capacity. If the market was not in over-supply then the outages would simply not have been approved by System Management.

Alinta also considers that:

- The IMO appears to be incorrectly assuming that having available capacity is the same as having reliable capacity[2]. There is no certainty that when dispatched capacity that had been made available through the Balancing Merit Order can perform and therefore meet the SWIS's reliability standards. While the expectation is that participants will in good faith bid into the market, for units, particularly those that are infrequently dispatched, there is a risk of plant failure on dispatch.

  While Alinta acknowledges the role of the Reserve Capacity Testing mechanism in reducing the risk of plant failure when dispatched it is not possible to entirely remove this risk. The proposed amendments will however potentially encourage greater availability at the risk of reducing reliability of some plants. This appears to be at odds with the objective of reliability embedded within Wholesale Market Objective (a) and the incentives of the Reserve Capacity Testing mechanism.

- There are off-market incentives for the availability of generators with higher fixed costs than the theoretical 160MW Open Cycle Gas Turbine used to determine the Maximum Reserve Capacity Price (i.e. base load and some mid-merit plants). These facilities will not receive sufficient compensation from the capacity market alone and so need to provide energy in order to cover their fixed costs.

  While removal of these facilities from the market may potentially increase the energy market price (as these facilities provide low cost energy) it is likely that they will have bilateral contracts in place which they would need to purchase energy to cover if they are on extended outages. Purchasing energy at a potentially higher cost than the generator could produce the energy at provides a strong commercial incentive to ensure these facilities are available and providing energy. It is unclear whether there has been adequate consideration of these off-market incentives for availability in developing the IMO's proposed amendments.

- The proposed amendments place an unnecessary regulatory burden on all Scheduled Generators, adding to the costs of operating in the market.

While noting our general opposition to the proposed changes, Alinta does however acknowledge that there could be further refinements made to the existing mechanisms under the rules for addressing high rates of unavailability of facilities. These would address the IMO's concerns with administering the existing rules while avoiding unnecessary intervention in the market. Details of Alinta's specific views on the proposed changes are outlined below.

1. Support greater flexibility in assigning CRC

Given the IMO's stated concerns with administering the existing rules we support:

- the proposed changes to permit the IMO more flexibility in assigning a quantity of CRC (between zero and full allocation) to Scheduled Generators displaying excessive outage rates over 36 months (clause 4.11.1(h));

[2] The definition of Power System Reliability (outlined in the Market Rules) is "*… the ability of the SWIS to deliver energy within reliability standards while maintaining Power System Adequacy and Power System Security*." The definition of Power System Adequacy refers to "*… the ability of the SWIS to supply all demand for electricity in the SWIS at the time, allowing for scheduled and unscheduled outages of generation, transmission and distribution equipment and secondary equipment*." While availability is not specifically defined in the Market Rules based on the use of the concept for the purposes of the Balancing market it is gleaned to refer to a facility having bid directly into the Balancing market. That is the facility is "available" for dispatch by System Management if required.

- specifying the range of factors the IMO will take into account in making its decision under clause 4.11.1(h); and
- the Public Utilities Office progressing necessary amendments to the Regulations to make decisions under clause 4.11.1(h) a reviewable decision.

Progression of these limited changes will address the IMO's noted concerns by incentivising Scheduled Generators to be available, while still being able to provide a clear signal for the retirement of inefficient plant. While we are supportive of this aspect of the proposal we consider that the additional proposed changes are unnecessary to incentivise availability.

Costs of implementing the proposed amendments: Alinta has not identified any costs to its business associated with these proposed changes. More broadly there may be a loss of capacity income incurred by some participants who are not fully certified.

2. Unnecessary to introduce a cap on Planned Outages and to tighten the combined outage rate

We consider that the following changes are unnecessary, will potentially distort the current incentives for centrally planning outages and result in unwarranted administration costs being incurred by the market:

- progressively tightening the combined Planned Outage rate and Forced Outage rate; and
- introducing a cap on Planned Outages (PO cap) under which a reduction in the RCOQ can be claimed.

We are concerned that as currently proposed the level of the cap (14.8% average over three years) may negatively impact on participants that are "doing the right thing". While we understand that the IMO is looking for a more immediate incentive to ensure facility availability, potential reductions in the level of CRC in the future will provide sufficient incentives for participants to make their facilities available. A rational investor in the WEM places significant value on having certainty around future income streams.

Imposing a limitation on the level of Planned Outages that a Facility may have over a three year period may be detrimental to reliability standards in the SWIS. This is because some facilities may need to reduce current levels of maintenance in order to make sure they do not breach the PO cap (and suffer financial penalties) there will likely be an impact on the reliability of facilities on the SWIS. Likewise there will be less opportunity for facilities to undertake upgrades that may in fact improve their overall performance. Given the nature of Alinta's generation assets it is unlikely that the proposed changes will impact on its operations, however we suggest that the IMO takes advice on this matters from other participants with different fuel types which require greater levels of maintenance (i.e. coal).

We note that under clauses 4.27.7 and 4.27.8 (proposed to be removed) the IMO is currently provided with discretion to limit Planned Outages under certain circumstances. While it is better regulatory practice to specify a value for the "cap" so as to provide certainty to all participants, given the wider impacts on reliability we do not consider any limitation on the level of Planned Outages undertake is required in this case. Rather poor availability should be dealt with by the IMO entirely through the assignment of CRC.

As a side point, we acknowledge that the IMO is looking at the incentives for centrally planning outages through a different proposal. It is unclear why this change would not be progressed as part of this package of amendments.

Costs of implementing proposed amendments: It is assumed that the proposed outage cap will be applied ex-post via the IMO's settlement processes. We note that this will require generators to continuous monitor their level of Planned Outages which will require changes to Alinta's current business practices and result in IT costs being incurred. Alinta is currently investigating the costs of any necessary changes.

3. Unnecessary to introduce changes to IMO's powers under clause 4.27

The proposed amendments to clause 4.27 create:

- regulatory burden by enabling the IMO to request performance reports; and
- regulatory uncertainty by enabling adjustments to a participants PO cap when the system capacity availability criterion is met.

These changes are not required to address the core issue under consideration by the IMO and should not be progressed.

Should the IMO continue to progress these changes Alinta supports any decisions to adjust a participants PO cap being a Reviewable Decision given that there is significant discretion afforded to the IMO with respect to how exactly it adjusts the maximum number of Trading Intervals that are eligible for a RCOQ adjustment. Likewise there should be full transparency of the IMO's decision making criteria in such cases.

Costs of implementing proposed amendments: There will be costs to participants associated the enactment of the IMO's expanded powers, in particular their ability to request performance reports. It is however not possible to estimate the costs to Alinta associated with this at this stage. They are however anticipated to be minor and infrequently incurred.

Enabling adjustments to a participants PO cap when the system capacity availability criterion is met will have financial costs of any impacted participants through the loss of capacity revenue. Once again it is not possible to estimate these costs to Alinta at this stage though they are anticipated to be minor and incurred only infrequently.