

Independent Market Operator



## **Final Market Rule Change Report**

### **Title: Maximum Reserve Capacity Price Methodology and Review**

Ref: RC\_2007\_24

Date: 19 November 2007

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## DOCUMENT DETAILS

IMO Report No.: RC\_2007\_24  
Report Title: Maximum Reserve Capacity Price Methodology and Review  
Release Status: Public  
Confidentiality Status: Public domain  
Published in accordance with Market Rule 2.6.4

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## 1. INTRODUCTION

### 1.1. General Information about Rule Changes

Clause 2.5.1 of the Wholesale Electricity Market Rules provides that any person (including the Independent Market Operator) may make a Rule Change Proposal by completing a Rule Change Proposal Form and submitting this to the Independent Market Operator (IMO).

In order for the proposal to be progressed, the change proposal must explain how it will enable the Market Rules to better contribute to the achievement of the wholesale electricity market objectives. The objectives of the market are:

- (a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system
- (b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors
- (c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions
- (d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system
- (e) to encourage the taking of measures to manage the amount of electricity used and when it is used

A Rule Change Proposal can be processed using a Standard process or a Fast Track process. The Standard process involves a combined 10 weeks public submission period. Under the shorter Fast Track process the IMO consults with Rule Participants who either advise the IMO that they wish to be consulted or the IMO considers have an interest in the change.

### 1.2. About this Rule Change

On 15 October 2007, the IMO submitted a Rule Change Proposal titled “Maximum Reserve Capacity Price Methodology and Review”.

The Proposal was processed using the Fast Track Rule Change Process, described in section 2.6 of the Wholesale Electricity Market Rules. The Fast Track Process was used as the proposal satisfied the requirements of clause 2.5.9 (c) of the Market Rules.

The Fast Track Process adheres to the following timelines, outlined in section 2.6 of the Market Rules:

- Within 5 Business Days of a Rule Change Notice being published, the IMO must notify any Rule Participants that the IMO intends to consult regarding the Rule Change.
- Within 5 Business Days of the Rule Change Notice being published, any Rule

Participant wishing to be consulted may contact the IMO to request consultation on the Rule Change.

- Within 15 Business Days of the Rule Change Notice being published, all consultations must be concluded.
- Within 20 Business Days of the Rule Change Notice being published, the IMO must publish a Final Rule Change Report and, when the change relates to a protected provision, provide the Final Report to the Minister for approval.
- The Minister must consider the Rule Change Proposal within 20 Business Days and decide whether the Market Rules, as amended or replaced by the proposed Amending Rules, are consistent with the Wholesale Market Objectives.

The key dates in processing this Rule Change Proposal were:

- The Rule Change Notice for this Proposal was published on the IMO website on 22 October 2007.
- On 23 October 2007, the IMO notified interested parties that it wished to consult regarding the Rule Change.
- Consultations on the Rule Change Proposal were completed on 12 November 2007.
- This Final Rule Change Report was published on 19 November 2007.
- The Minister's decision on the Final Rule Change Report and the Market Rule Change Proposal is expected to be available by 17 December 2007.

This Final Rule Change Report on the Rule Change Proposal has been prepared by the IMO in accordance with clause 2.6.4 of the Market Rules.

Based on its analysis against the Market Objectives and the responses received from interested parties, the IMO's decision is to accept the Rule Change in the form outlined in this Final Report.

## 2. THE RULE CHANGE PROPOSAL

### 2.1. The Submission

The IMO submitted, on 15 October 2007, a Rule Change Proposal to allow the results of a review, conducted to assess the appropriateness of the parameters used to determine the Maximum Reserve Capacity Price, to be considered when revising the Maximum Reserve Capacity Price.

#### 2.1.1. Submission details

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Date Submitted:	15/10/2007
Urgency:	High

### 2.2. The Proposal

The IMO submitted that clauses 4.16.3 and 4.16.4 of the Wholesale Electricity Market Rules provide for an annual review to be conducted by the IMO to assess the appropriateness of some of the parameters that are used to determine the Maximum Reserve Capacity Price. The following clause, 4.16.5, provides a mechanism by which the IMO proposes a revised Maximum Reserve Capacity Price. However, the linkage between the review and the proposal of the revised value could be enhanced.

The IMO has established an industry-based Advisory Group to assist in a more general review of the Maximum Reserve Capacity Price. One of the outcomes of this review has shown that the methodology used to estimate the capital cost of an Open Cycle Gas Turbine (OCGT) power station currently under-estimates the real cost of building such a plant. This has resulted from a change in the construction and engineering environment over the past few years. In this case, applying the methodology as currently outlined in Appendix 4 of the Wholesale Electricity Market Rules would result in an outcome that is not reflective of today's construction and engineering cost environment.

Therefore, the IMO's Rule Change Proposal aims to introduce a mechanism by which the outcome of the review can be considered when revising the Maximum Reserve Capacity Price and to take account of methodology changes if they are significant and can be substantiated.

A significant change to the methodology would be one where the IMO provides evidence that the application of the existing methodology would have a material impact on the Maximum Reserve Capacity Price, and where adjusting the methodology better supports the Wholesale Electricity Market Objectives. Changes to the methodology will be limited to the parameters that are reviewed each year under clause 4.16.4 of the Wholesale Electricity Market Rules.

The review conducted in accordance with clause 4.16.3 and 4.16.4 of the Wholesale Electricity Market Rules for the 2008 Reserve Capacity Cycle (for capacity that will be

available from 1 October 2010 to 1 October 2011) has already commenced. The IMO's draft report will propose a revised value which will be subject to public consultation (in accordance with clause 4.16.6). Submissions made by interested parties will be taken into consideration when the IMO produces its Final Report and final revised Maximum Reserve Capacity Price for approval by the Economic Regulation Authority.

### **2.3. Amending Rules Proposed by the IMO**

The amendments proposed by the IMO can be found in Section 5 of this Report.

### **2.4. The IMO's Initial Assessment of the Proposal**

The IMO decided to proceed with the Rule Change Proposal on the basis of its preliminary assessment which indicated that the Proposal was consistent with the Market Objectives.

The proposal was processed using the Fast Track Rule Change process described in section 2.6 of the Wholesale Electricity Market Rules. The Fast Track Process was used as the proposal satisfied the requirements of clause 2.5.9 (c) of the Market Rules. The IMO considered that the change was urgently required and essential in order to set an effective and efficient Maximum Reserve Capacity Price for the 2010/11 Reserve Capacity Cycle.

Section 2.5.9 states:

*The IMO may subject a Rule Change Proposal to the Fast Track Rule Change Process if, in its opinion, the Rule Change Proposal:*

- (a) is of a minor or procedural nature; or*
- (b) is required to correct a manifest error; or*
- (c) is urgently required and is essential for the safe, effective and reliable operation of the market or the SWIS.*

### 3. RULE PARTICIPANTS CONSULTED

For this Rule Change, the IMO notified the following interested parties of its intention to consult:

- Alcoa World Alumina Australia
- Alinta Sales Pty Ltd
- Barrick (Kanowna) Limited
- Bioenergy Limited
- Economic Regulation Authority
- Eneabba Gas Pty Ltd
- Griffin Energy
- Karara Energy
- Landfill Gas and Power Pty Ltd
- Mount Herron Engineering
- NewGen Neerabup Pty Ltd
- NewGen Power Kwinana Pty Ltd
- Newmont Asia Pacific
- Office of Energy
- Perth Energy Pty Ltd
- Premier Power Sales Pty Ltd
- Skyfarming Pty Ltd
- Synergy
- System Management
- TransAlta Energy
- Verve Energy
- Wambo Power Ventures
- Waste Gas Resources Pty Ltd
- Water Corporation
- Western Australia Biomass Pty Ltd (Babcock and Brown)
- Western Power Corporation

In addition to IMO's notification, an invitation for interested parties to contact the IMO, should they wish to be consulted on this Rule Change, was published on the IMO website on 22 October 2007.

The IMO requested the interested parties to provide their views on the Rule Change in writing.

The IMO received responses from Alinta Sales, Landfill Gas and Power, and Synergy. Below is a summary of the received feedback. The IMO's response to the issues raised can be found in Section 4 of this Report.

### **3.1. Market Advisory Committee**

The Market Advisory Committee (MAC) was invited to have preliminary discussions on the Proposal at its meeting on 10 October 2007, before it was formally submitted by the IMO. At the meeting, Alinta raised the question as to whether this proposal would allow the IMO to not only change the values but also the components making up the Maximum Reserve Capacity Price under clause 4.16.4. The IMO emphasised that under this proposal the IMO would only change the value of a variable and not add or subtract components. Alinta was satisfied with this intent.

MAC expressed general support of the interim solution in the Rule Change Proposal, and also that the proposal should be fast tracked in order to have the change implemented for the current review of the Maximum Reserve Capacity Price.

### **3.2. Alinta Sales**

While expressing its support for the Rule Change Proposal, Alinta repeated the concern it raised at the MAC meeting 10 October 2007, regarding the interpretation of the Rule Change:

*“The additional words that are proposed to be inserted into the rules are “...after taking into account any significant modifications to the methodology resulting from the review...”. Alinta’s understanding is that “modifications to the methodology” is to be taken to mean proposed changes to the parameters set out in the methodology already described in the Market Rules rather than out of hand accepting a completely new methodology for calculating the Reserve Capacity Price. Such significant changes to the underlying rationale for how to calculate the administered price should only be allowed following another rule change with appropriate time allowed for consultation.”*

### **3.3. Landfill Gas and Power**

Landfill Gas and Power (LGP) expressed its support for the proposed change. LGP agreed that the rule change will promote the economically efficient, safe and reliable production and supply of electricity and, by ensuring that the Maximum Reserve is cost-reflective, competition among generators and retailers will also be improved by facilitating efficient entry of new competitors.

### **3.4. Synergy**

Synergy expressed its support for the proposed changes.



## 4. THE IMO'S ASSESSMENT AND DECISION

### 4.1. Assessment

#### 4.1.1. Consultations

All parties responding to IMO's request for consultation expressed support for the IMO's proposal. No party proposed any changes to the amendments to the Market Rules proposed by the IMO.

Alinta expressed concerns at the possibility of the review changing not only the variables of the Maximum Reserve Capacity Price methodology but adding or subtracting components which would completely change the methodology. As indicated, in response to Alinta's concern at the October MAC meeting, the IMO confirms that the outcome of this rule change means that the IMO would only change a value listed in clause 4.16.4 and not add or subtract values from the methodology. More significant changes to the methodology will be addressed by subsequent Rule Changes on the basis of the industry-based Advisory Group's recommendations.

#### 4.1.2. The IMO's Assessment

According to clauses 2.4.2 of the Market Rules *"the IMO must not make Amending Rules unless it is satisfied that the Market Rules, as proposed to be amended or replaced, are consistent with the Wholesale Market Objectives"*.

The IMO' assessment against each of the Market Objectives is as follows:

- (a) *to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system.*

Assessment: The Reserve Capacity Mechanism is an important component of the Wholesale Electricity Market and measures taken to ensure that the Maximum Reserve Capacity Price is cost-reflective will further the achievement of this objective. In its submission, Landfill Gas and Power supported this assessment.

- (b) *to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors.*

Assessment: The IMO considers that this rule change proposal supports objective (b) of the Wholesale Electricity Market Rules by encouraging the efficient entry of new facilities (and new competitors) into the Wholesale Electricity Market. In its submission, Landfill Gas and Power supported this assessment.

- (c) *to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions.*

Assessment: The IMO considers that the proposed changes do not impact on, and therefore are consistent with, the operation of objective (c) of the Market Objectives.

- (d) *to minimise the long-term cost of electricity supplied to customers from the South West interconnected system*

Assessment: The IMO considers that through the expected positive contribution to the achievement of objectives (a) and (b), the proposed changes are consistent with the operation of objective (d) of the Market Objectives.

- (e) *to encourage the taking of measures to manage the amount of electricity used and when it is used.*

Assessment: The IMO considers that the proposed changes do not impact on, and therefore are consistent with, the operation of objective (e) of the Market Objectives.

In accordance with Clause 2.4.3(b) of the Market Rules, in deciding whether or not to make Amending Rules, the IMO must also have regard to the practicality and cost of implementing the Amending Rules.

The implementation of this change will not require changes to the Wholesale Electricity Market System operated by the IMO. No other costs have been identified in relation to this change during the consultation process.

## **4.2. The IMO's Decision**

The IMO's decision is to:

- Accept the proposed amendments to clause 4.16.5 of the Wholesale Electricity Market Rules.

The IMO has made its decision on the basis that the resulting Amending Rules are consistent with the Market Objectives.

The wording of the relevant Amending Rules is presented in Section 5 of this Report.

## **4.3. Minister Approval**

Clause 4.16.5 of the Market Rules is a Protected Provision, as specified in clause 2.8.13 of the Market Rules. Amendments to Protected Provisions require approval from the Minister for Energy. As required under clause 2.8.3 of the Market Rules, the IMO will

submit this Final Rule Change Report to the Minister for Energy for his consideration. The Minister's decision is expected to be available by 17 December 2007.

#### ***4.4. Amending Rules Commencement***

Subject to receipt of the Minister's approval, the amendments to clause 4.16.5 of the Wholesale Electricity Market Rules are expected to commence at 08.00am on 20 December 2007.

## 5. AMENDING RULES

The following clause is amended as follows (~~deleted wording~~, new wording):

### ***Clause 4.16.5***

- 4.16.5 The IMO must propose a revised value for the Maximum Reserve Capacity Price using the methodology described in Appendix 4 after taking into account any significant modifications to the methodology resulting from the review conducted in accordance with clause 4.16.3 and 4.16.4.