



Final Rule Change Report
Title: LNG to be added to Liquid Fuel
Definition

Ref: RC_2008_23

Standard Rule Change Process

Date: 20 October 2008

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Independent Market Operator

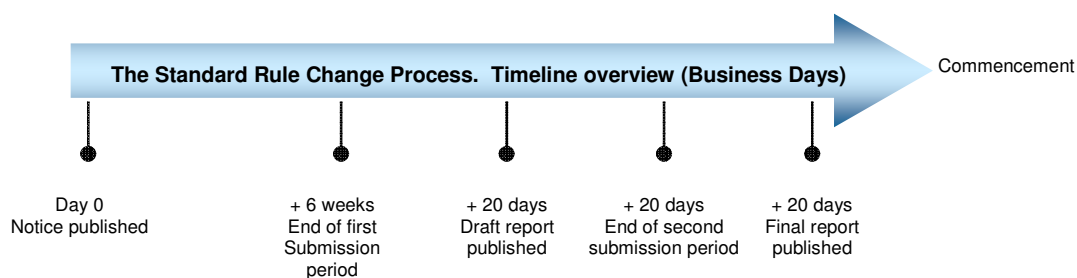
Level 3, Governor Stirling Tower
197 St George's Terrace, Perth WA 6000
PO Box 7096, Cloisters Square, Perth WA 6850
Tel. (08) 9254 4300
Fax. (08) 9254 4399
Email: imo@imowa.com.au
Website: www.imowa.com.au

1. INTRODUCTION

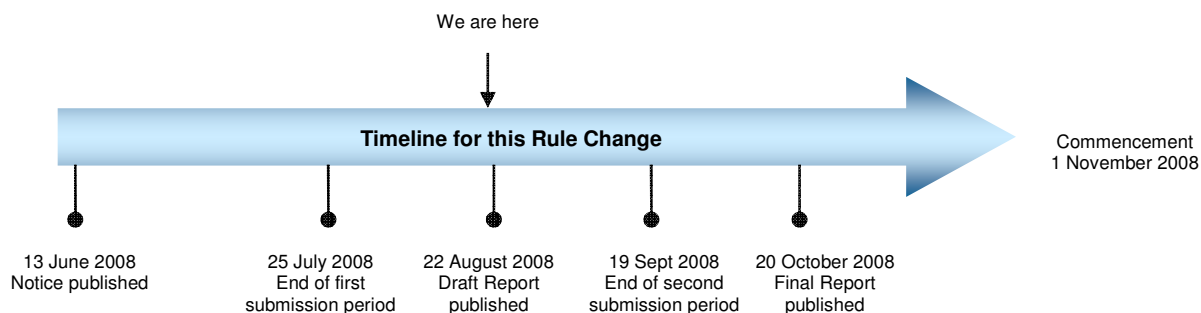
On 4 June 2008 NewGen Neerabup (NewGen) submitted a Rule Change Proposal regarding changes to the Glossary of the Wholesale Electricity Market Rules (Market Rules).

This Proposal is being processed using the Standard Rule Change Process, described in section 2.7 of the Market Rules.

The standard process adheres to the following timelines, outlined in section 2.7 of the Market Rules:



The key dates in processing this Rule Change Proposal are:



Based on the submissions received, the IMO's draft decision is to implement the Rule Change Proposal in the form outlined in section 7 of this Report.

This Final Rule Change Report on the Rule Change Proposal has been prepared by the IMO in accordance with clause 2.7.8 of the Market Rules.

The amendments to the Market Rules made as a result of this Rule Change Proposal will commence at 08.00am on 1 November 2008.

2. THE RULE CHANGE PROPOSAL

2.1. Submission Details

Name:	Gregg Buskey
Phone:	+61 7 3020 5107
Fax:	+61 7 3020 5111
Email:	gbuskey@ermpower.com.au
Organisation:	NewGen Neerabup Pty Ltd
Address:	
Date submitted:	04 th June 2008
Urgency:	3-high
Change Proposal title:	LNG to be Added to Liquid Fuel Definition

2.2. Details of the Proposal

NewGen submitted that under the present Market Rules, dispatch on Liquid Fuel (as defined in Chapter 11) allows Generators to offer energy at up to the Alternative Maximum STEM Price. However, NewGen noted that the definition of Liquid Fuel does not include Liquefied Natural Gas (LNG) making it, by definition, a Non-Liquid Fuel.

NewGen submitted that while LNG spot prices are comparable to spot prices of other Liquid Fuels (translating into around \$20-\$120/MWh cheaper electricity than that produced by the current range of Liquid Fuels), they are materially higher than the prices of Non-Liquid Fuels. Under the current market rules LNG fuelled generation is not, according to NewGen's submission, economic to dispatch unless a generator can bid above the Maximum STEM Price. Thus, given LNG's comparable price to other Liquid Fuels, NewGen argued that it is currently not economically viable for Generators to use the environmentally friendlier LNG as an alternate back-up fuel to LPG, distillate, or fuel oil.

Pricing analysis, comparing different types of fuels was included in NewGen's Rule Change Proposal, published on the IMO website.

2.3. The Proposal and the Market Objectives

NewGen submitted that the Rule Change Proposal will have the following impact on the market objectives:

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

Making another liquid fuel economically viable will increase potential fuel diversification which in turn may increase reliability.

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

No change, apart from introducing diversity into upstream fuel supply.

- (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;*

Greenhouse gas emissions associated with LNG are 11%-28% lower than emissions associated with the range of Liquid Fuels as presently defined. The proposed rule change will remove the current discrimination against using this cleaner fuel type by making it economic to use. Further details of the environmental credentials claimed by NewGen are set out in the Rule Change Proposal.

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

LNG, while being comparably priced to Liquid Fuels as presently defined, is still \$20-\$120/MWh cheaper than the price range of existing Liquid Fuels. Further, adding an additional fuel option will promote further competition in the Liquid Fuel space reducing the cost of Liquid Fuel dispatch and ultimately reducing the cost of wholesale electricity during high-peak periods. Western Australia has significant gas resources and LNG production capability. The West Kimberley Project which has recently been commissioned by EDL represents the benefits of using LNG over diesel in Western Australia. Further price comparative analysis is set out in the Rule Change Proposal.

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

No change.

2.4. Amending Rules proposed by the IMO

The amendments to the Market Rules proposed by NewGen are set out in Section 7 of this Report.

2.5. The IMO's Initial Assessment of the Proposal

The IMO decided to proceed with the proposal on the basis of its preliminary assessment, which indicated that the proposal was consistent with the Wholesale Market Objectives. This preliminary assessment was published in a Rule Change Notice on 13 June 2008.

3. SUBMISSIONS RECEIVED IN THE FIRST SUBMISSION PERIOD

The IMO received two submissions on the changes proposed by NewGen. These were from Synergy, and Landfill Gas and Power Pty Ltd. The submissions are summarised below, and the full text is available on the IMO website.

3.1. *Market Advisory Committee*

The Market Advisory Committee (MAC) was first advised of the proposed rule change at its meeting on 14 November 2007. At the meeting, MAC was in general support of the intent of the change, to amend the rules to include LNG in the definition of liquid fuel. However, before accepting that the Alternative Maximum STEM Price is the appropriate cap for LNG, MAC requested evidence that LNG sourced in WA will be priced in line with distillate fuel.

NewGen provided this analysis to MAC, together with a revised proposal, at the MAC meeting on 14 May 2008. The analysis is also included in NewGen's Rule Change Proposal, as published on the IMO website. Following NewGen's presentation at the meeting, MAC agreed with the principles of the proposal and that it should proceed as a formal Rule Change Proposal.

3.2. *Submission from Synergy*

Synergy submitted that it is generally sympathetic to the objectives of the proposal. However, Synergy also contended that it could not support this proposal unless the definition of Liquid Fuel in Chapter 11 of the Market Rules is revised to include, along with LNG, all other types of gas that have been stored and which are subsequently used to provide instantaneous power to the system.

Synergy proposed a revision to the proposal so that the definition of Liquid Fuel is extended to include Stored Gas (defined to include all types of stored gas, including LNG).

3.3. *Submission from Landfill Gas and Power Pty Ltd (LGP)*

In its submission LGP expressed support for the intent of the Rule Change proposal on the grounds that it would facilitate the use of LNG fuel as an environmentally-friendly and lower-cost alternative to presently defined liquid fuels. Without the rule change, LGP agreed that LNG could not be efficiently dispatched.

LGP supported NewGen's contention that the Rule Change would increase system security via enhanced fuel diversity, lower the cost of electricity by offering a lower cost fuel for peaking energy, and reduce greenhouse gas emissions.

3.4. *Public Forums and Workshops*

No public forums or workshops were held in relation to this Rule Change.

3.5. *Assessment*

All parties responding within the prescribed submission period expressed principal support for the Rule Change Proposal.

Synergy submitted that it would like to see the definition of Liquid Fuel extended to include all other types of gas that have been stored and which are subsequently used to provide instantaneous power to the system.

The IMO noted that the proposal has been assessed at two MAC meetings, at the first of which MAC requested additional analysis that supports this proposal. Synergy, along with the other MAC members, agreed at the MAC meeting on 14 March 2008 that the proposal should proceed as proposed by NewGen and that any further amendments to the Rules in relation to the price caps should be deferred to future analysis.

Further, the IMO noted that Synergy has not provided a clear definition of what the term “Stored Gas” consists of and which liquid fuel sources, other than those already included in the definition of Liquid Fuel, would be encompassed by the definition of “Stored Gas”, proposed by Synergy. The IMO considered that amending the definition of Liquid Fuel, as proposed by Synergy, would lead to uncertainty in the market in regard to which fuels are actually included in the Liquid Fuel definition.

The IMO considered that, given the extensive discussions at MAC regarding NewGen’s proposal, more analysis and evidence is required to support Synergy’s proposal, and that this would be more appropriately dealt with as a further proposal to amend the Market Rules.

The IMO decided not to incorporate Synergy’s proposed amendments in its draft amending rules.

4. THE IMO'S DRAFT DECISION

4.1. *The IMO's Draft Decision*

The IMO's draft decision was to implement the proposed amendments to the definition of Liquid Fuel in the Wholesale Electricity Market Rules as proposed by NewGen.

The IMO made its draft decision on the basis that the resulting Amending Rules will allow the Market Rules to better address the Wholesale Market Objectives.

The wording of the relevant Amending Rules is presented in section 7 of this Report.

5. SUBMISSIONS RECEIVED IN THE SECOND SUBMISSION PERIOD

Following the publication of the Draft Rule Change Report on the IMO web site, the second submission period was between 25 August 2008 and 19 September 2008. The IMO received one submission from Verve Energy. The submission is summarised below, and the full text is available on the IMO website.

5.1. *Submission from Verve Energy*

In its submission Verve Energy noted its support for the proposed rule change. In addition to this Verve Energy contended that the proposal does not address potential issues and inefficiencies created by the inclusion of lower-cost alternatives to distillate, such as LPG and LNG, in the liquid fuel definition. These include:

- the requirement for System Management to dispatch Verve Energy facilities in balancing when lower-cost IPP generation may be available; and
- the increased potential for Market Generators to extract unreasonable profits based on the higher Alternate Maximum STEM Price, the absence of SRMC pricing obligations on all participants and adequate competition in the fuel segment.

Verve Energy contended that these issues could be adequately addressed via the introduction of a third fuel type with an associated price cap, or by introduction of an improved balancing regime, removal of the Maximum STEM Price and/or imposition of SRMC based pricing obligations on all market participants, including in balancing. Given that such changes would be significantly more complex and encompass broader considerations than simply the definition of LNG, Verve Energy considered they would be best addressed via a separate rule change proposal.

6. THE IMO'S ASSESSMENT AND DECISION

6.1. Assessment

6.1.1 Submissions

All parties responding within the prescribed submission period expressed principal support for the Rule Change Proposal.

During the first submission round Synergy submitted that it would like to see the definition of Liquid Fuel extended to include all other types of gas that have been stored and which are subsequently used to provide instantaneous power to the system.

The IMO notes that the proposal has been assessed at two MAC meetings, at the first of which MAC requested additional analysis that supports this proposal. Synergy, along with the other MAC members, agreed at the MAC meeting on 14 March 2008 that the proposal should proceed as proposed by NewGen and that any further amendments to the Rules in relation to the price caps should be deferred to future analysis.

Further, the IMO notes that Synergy has not provided a clear definition of what the term "Stored Gas" consists of and which liquid fuel sources, other than those already included in the definition of Liquid Fuel, would be encompassed by the definition of "Stored Gas", proposed by Synergy. The IMO considers that amending the definition of Liquid Fuel, as proposed by Synergy, will lead to uncertainty in the market in regard to which fuels are actually included in the Liquid Fuel definition.

The IMO considers that, given the extensive discussions at MAC regarding NewGen's proposal, more analysis and evidence is required to support Synergy's proposal, and that this would be more appropriately dealt with as a further proposal to amend the Market Rules.

The IMO has therefore decided not to incorporate Synergy's proposed amendments in its draft amending rules.

During the second submission round Verve Energy noted its support for the proposed rule change. In addition to this Verve Energy contended that the proposal did not address potential issues and inefficiencies created by the inclusion of lower-cost distillate alternatives, such as LPG and LNG, in the liquid fuel definition. It was noted that these issues could be adequately addressed via:

- (a) the introduction of a third fuel type with an associated price cap;
- (b) the introduction of an improved balancing regime;
- (c) the removal of the Maximum STEM Price; and/or
- (d) the imposition of SRMC based pricing obligations on all market participants, including in balancing.

Given that such changes would be significantly more complex and encompass broader considerations than simply the definition of LNG, Verve Energy considered they would be best addressed via a separate rule change proposal.

The IMO agrees that any potential amendments to address the issues raised by Verve Energy would require greater analysis and would be more appropriately dealt with as a further proposal to amend the Market Rules.

As part of the Market Rules Evolution Plan 2008 – 2011 the IMO intends to undertake reviews of both the balancing mechanism and the price caps which will address the issues raised in the Verve Energy submission.

6.1.2 The IMO's Assessment

According to clause 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 considers that the proposed Amending Rules will have the following impact on how the Market Rules address the Wholesale Market Objectives:

Impact	Wholesale Market Objectives
Allow the Market Rules to better address objective	a , c and d
Consistent with objective	b and e
Inconsistent with objective	-

The IMO's assessment against market objectives (a), (c) and (d) 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;*

The proposed amendments allow the Market Rules to better address objective (a) of the Market Objectives. The change will allow LNG to be a financially viable back up fuel for generators. Currently, distillate is the primary back up fuel source in the SWIS and using LNG will help to mitigate the risk of relying solely on distillate for this purpose. In its submission, LGP agreed with 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;*

The proposed amendments allow the Market Rules to better address objective (c) of the Market Objectives. The proposed rule change will make LNG an economically viable fuel source to use in the SWIS.

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

The proposed amendments allow the Market Rules to better address objective (d) of the Market Objectives. LNG, while priced above natural gas, is still cheaper than the range of existing liquid fuels. A generator using LNG will be able to offer electricity at a lower price than electricity generated from other liquid fuels. Further, allowing LNG to become

a financially viable fuel option for generators will promote further competition in the liquid fuel space and potentially contribute to reducing the cost of liquid fuel dispatch during peak demand periods. In its submission, LGP agreed with this assessment.

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 proposed changes will not require any changes to the Wholesale Electricity Market Systems operated by the IMO. No other costs have been identified in relation to the implementation of the proposed changes.

6.2. *IMO's Final Decision*

The IMO's final decision is to implement the proposed amendments to the definition of Liquid Fuel in the Wholesale Electricity Market Rules as proposed by NewGen.

The IMO has made its draft decision on the basis that the resulting Amending Rules will allow the Market Rules to better address the Wholesale Market Objectives.

The wording of the relevant Amending Rules is presented in section 7 of this Report.

6.3. *Amending Rules Commencement*

The amendments to the Market Rules resulting from this Rule Change Proposal will commence at **08.00am** on **1 November 2008**.

7. PROPOSED AMENDING RULES

The IMO proposes to implement the following new clauses to the Market Rules (~~deleted words~~, added words):

Chapter 11 – Glossary

Liquid Fuel: Means distillate, fuel oil, or liquid petroleum gas, or liquefied natural gas.

8. GENERAL INFORMATION ABOUT RULE CHANGE PROPOSALS

Clause 2.5.1 of the Wholesale Electricity Market Rules (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 Market Objectives. The market objectives are:

- (e) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system
- (f) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors
- (g) 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
- (h) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system
- (i) 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 Rule Change Process or a Fast Track Rule Change 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.