20 November 2008

Alinta

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Dear Allan

WEM RULE CHANGE PROPOSAL RC_2008_27 – FUNDING OF SUPPLEMENTARY RESERVE CAPACITY

Thank you for the opportunity to attend the workshop on Rule Change Proposal RC_2008_27 “Funding of Supplementary Reserve Capacity” on Friday 14 November 2008 and to comments on the Independent Market Operator’s (IMO) Draft Rule Change Report. This letter sets out the views of Alinta Sales Pty Ltd (“Alinta”).

The proposed change

On 28 August 2008, the IMO submitted RC_2008_27, proposing to change the Wholesale Electricity Market Rules (“the Market Rules”) relating to the funding arrangements for Supplementary Reserve Capacity (SRC).

Currently, the Market Rules stipulate that the costs of funding capacity are to be divided into a “Shared Capacity Cost” and a “Targeted Capacity Cost”. All Market Customers (predominantly electricity retailers) are liable, in proportion to their Individual Reserve Capacity Requirements (IRCR), for the costs allocated to the Shared Capacity Cost pool. Conversely, only Market Customers that do not have bilateral IRCR cover are required to fund Targeted Capacity Costs.

Costs that may be incurred when SRC is required to be procured are currently classified as a Targeted Capacity Cost. The IMO has proposed that the Market Rules be changed so that SRC costs are funded from the Shared Capacity Cost pool.

Alinta’s view

Context

As stated at the workshop, Alinta believes that the current rule change proposal has been driven by the potential for SRC being called this summer due to late commissioning generators. Alinta agrees that the current Market Rules relating to the allocation and funding of SRC costs need to be changed.

However, as pointed out in our initial response and at the workshop, Alinta believes the guiding principle for cost allocation in general should be to target costs as much as possible to those that cause those costs and are best able to manage the risk factors related to the cost. The rule change proposal does not achieve that, and instead seeks to socialise the cost over a larger retail base than is currently the case.

Alinta's view as set out in its initial consultation response remains unchanged. For the reasons set out in the initial consultation response, Alinta considers the rule change proposal on its own would be detrimental to achieving the objectives of the market and as such should not be made. The effect of the rule change proposal may reduce incentives for managing the entry (and exit) of generation and load into the WEM.

Under the current Market Rules, retailers are able to avoid potential exposure to SRC costs by ensuring they hold sufficient bilateral capacity credit cover. Alinta continues to believe that the current treatment of SRC costs provides an incentive for retailers to enter into bilateral capacity credit contracts which provide long term certainty on cash flow for new generators, underpinning long term investment in generation. Retailers with bilateral contracts are arguably paying an insurance premium to avoid exposure.

At the workshop a view was presented that retailers with a long capacity credit position would always seek to withhold capacity from the market to ensure "someone else" picks up the total SRC cost. As stated in our earlier submission, at the MAC and at the workshop, Alinta has a long position in terms of capacity credits. Further, a number of retailers have approached Alinta to discuss purchasing capacity credits to cover a shortfall in their IRCR. Alinta has offered to contract with those retailers for capacity credits at competitive prices based on the Administered Reserve Capacity Price and anticipated movements in that price over the contract term requested by the retailer. However, to date, retailers have opted not to contract with Alinta for any capacity credit shortfall to their IRCR.

Alinta notes that the Economic Regulation Authority (ERA) and the IMO have powers to monitor and investigate behaviour in the market. If market participants were concerned about anti-competitive behaviour influencing the bilateral capacity credit market this should be brought to the attention of the ERA and the IMO.

Alinta notes small retailers have expressed concerns about their potential "uncapped" exposure to SRC, but considers that this risk could be easily managed by these retailers at minimal cost by contracting bilaterally. Consequently, Alinta does not consider that a change in the Market Rules is necessary to protect small retailers.

The Rule Change Proposal

Alinta considers that RC_2008_27, in isolation, will not better contribute to the achievement of the wholesale market objectives. [1]

Alinta notes that the IMO has proposed a further Rule Change Proposal (RC_2008_34 "Funding of SRC in event of capacity credit cancellation") which, in assessing whether or not RC_2008_27 better achieves the market objectives, it has assumed will be implemented.

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[1] The objectives of the Market Rules are contained in Market Rule 1.2.1 and 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"

It is unclear to Alinta whether, in assessing RC_2008_27, the IMO is able (or whether it is prudent) to assess the extent to which the proposed rule change better achieves the market objectives based on the current Rule Change Proposal (RC_2008_27) being supplemented at a later date by a further Rule Change Proposal (RC_2008_34).

Specifically, Alinta is concerned that RC_2008_27 on its own:

- *may not facilitate the efficient new entry of competitors, particularly in the generation sector.*

  To the extent that small retailers do not hold sufficient capacity credits to meet their IRCR, they may be exposed to material SRC costs (relative to their cost base) under the current market rules. RC_2008_27 would expose each retailer to SRC costs in proportion to their IRCR, which may significantly reduce the financial exposure of small retailers that do not hold sufficient capacity credits to meet their IRCR. Consequently, RC_2008_27 may support retail market entry.

  However, RC_2008_27 potentially also removes incentives for retailers, including small retailers, to efficiently contract with new entrant electricity generators and underpin long term investment in generation. The risk of delays in the commissioning of new generation plant, which led to RC_2008_27, is a prime example. Consequently, RC_2008_27 may not support efficient new entry of generations in the South West interconnected system or efficient retail competition.

- *may not promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected systems.*

  RC_2008_27 (of itself) is not likely to promote the economically efficient supply of electricity as it removes incentives from new entrant retailers to effectively manage their contractual relationships with capacity providers.

Alinta contends that the short comings of RC_2008_27 were recognised by the SRC Working Group, which concluded that there are a number of different drivers that could lead to a shortfall in reserve capacity and that in certain circumstances, individual Market Customers should be exposed to any resultant SRC costs. Some of these changes will be implemented if RC_2008_34 is approved.

It is unclear to Alinta whether it is prudent or permissible under the current Market Rules to assess the extent to which a proposed rule change better achieves the market objectives based on the current Rule Change Proposal being supplemented at a later date by a further Rule Change Proposal.

Alinta considers that RC_2007_27 in isolation would not better achieve market objectives (a) and (b) relating to efficiency and competition and therefore should not be approved.

If the IMO were to conclude differently and approve RC_2007_27 Alinta considers it should direct that the implementation timetable should be set so that it coincides with the likely implementation timetable of RC_2008_34 recognising the linkages that the IMO has already drawn between the two rule change proposals.

IT systems and cost implications

Alinta has not identified any significant cost impact for its own IT systems.

Time required for implementation

Alinta does not require any specific lead time to allow implementation of the proposal.

Please call me on 08 9486 3749 to discuss any of the issues raised in this letter in more detail.

Yours sincerely

Corey Dykstra
Manager Regulatory Affairs