Wholesale Electricity Market
Rule Change Proposal Submission Form

RC_2008_34 Funding of Supplementary Reserve Capacity in the Event of Capacity Credit Cancellation

Submitted by

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Submission

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

Background

RC_2008_34 was submitted by the IMO on 2 October 2008, and was intended to supplement RC_2008_27 (Funding of Supplementary Reserve Capacity) which commenced on 1 January 2009. RC_2008_27 amended the Market Rules to move any net payments that might be made by the IMO for Supplementary Capacity Contracts out of the Targeted Reserve Capacity Cost and into the Shared Reserve Capacity Cost (which would be shared amongst all Market Customers).

RC_2008_34 would further amend the Market Rules so that in certain circumstances the cost of Supplementary Capacity Contracts would be targeted at specific Market Participants, rather than being included in the Shared Reserve Capacity Cost that would be met by Market Customers. These circumstances were to include where:

- a Facility fails a second reserve capacity test and the IMO reduces the number of reserve capacity credits held by the Market Participant for that Facility (existing Market Rule 4.25.4); or
- a Market Participant applies for a reduction in the number of reserve capacity credits held by the Market Participant for a Facility (existing Market Rule 4.25.4C); or

- a Facility suffers an extended Forced Outage (proposed new Market Rule 4.28.4B).

In the first two situations, the maximum payment that a Market Participant was to be required to make to the IMO would be equal to the full value of the reduced reserve capacity credits based on:

- the Reserve Capacity Price (divided by 12), if a Reserve Capacity Auction was held; or otherwise
- 85 per cent of the Maximum Reserve Capacity Price (divided by 12).

In the case of an extended forced outage (the third situation), the maximum payment was to be equal to half the value of the reduced reserve capacity credits based on:

- the Reserve Capacity Price (divided by 12), if a Reserve Capacity Auction were held, or otherwise
- 85 per cent of the Maximum Reserve Capacity Price (divided by 12).

IMO Draft Decision

The IMO's draft decision was to accept RC_2008_34, contingent on further amendments to the Market Rules that were designed, in part, to address the suggested revisions identified in Alinta's initial submission on the rule change proposal.

Alinta believes there may still be some ambiguity in the wording of the proposed Market Rule 4.28.4.C,which may not be overcome by the further revisions to the clause contained in the subsequent Addendum to the IMO's Draft Rule Change Report.

Alinta considers the intent of the proposed Market Rule 4.28.4C may be able to be clarified through the following revisions (to the wording of the proposed Market Rule 4.28.4C contained in the Addendum to the Draft Rule Change Report).

4.28.4.C For the avoidance of doubt, Cclauses 4.28.4A and 4.28.4B apply:

(a) to ~~the~~a Facility holding Capacity Credits~~,~~ in respect of Demand Side Management~~ for a Curtailable Load~~ ~~holding Capacity Credits~~; and

(b) to ~~the~~a Demand Side Programme holding Capacity Credits~~, in respect of a Demand Side Programme~~.

Public workshop

A Public Workshop, facilitated by the IMO and McLennan Magasanik Associates (MMA), was held on 28 April 2009 to discuss RC_2009_34. In its report to the IMO, MMA identified the key issues discussed at the workshop included the following.

- The risk coverage of the Reserve Capacity Mechanism and whether the risk beyond 1 year in 10 as managed through SRC can be reasonably allocated to the generators causing that level of capacity loss on such an infrequent basis.
- The rejection of causer pays for extreme events that require SRC. It was argued that the causer for extreme events is the retailer, not the generator due to the nature of the Reserve Capacity Mechanism.

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- Griffin Energy's claim that it was not able to insure the exposure to SRC cost for late commissioning at the current stage of its (Bluewaters) project.

In its report, MMA made the following recommendations.

- RC_2008_34 not proceed pending a broader review of the framework for SRC provision and the management of extreme capacity shortages on an economic basis. This would assist in limiting the exposure to SRC costs and provide a more robust framework for risk assessment by market participants.
- At the very least the proposed Market Rules 4.28.4(aA) (iii) and 4.28.4B that pertain to extended Forced Outages be removed pending a review of the allocation of SRC costs to generators at a level which would be acceptable and insurable.

Alinta's views

Alinta has previously commented (in relation to RC_2008_27) that it considers that the guiding principle for allocation of SRC costs should be to target those costs as far as possible to those that cause the costs and are therefore best placed to manage the associated risk factors. For this reason, Alinta supports in principle the thrust of the amendments to the Market Rules that would result from RC_2008_34.

However, Alinta acknowledges that the issues associated with the amendment of the Market Rules to target potential SRC costs in circumstances where a Facility's capacity credits are reduced, either voluntarily or by the IMO, differ from a situation where a Facility suffers an extended Forced Outage. These two circumstances are discussed in turn below.

Reduction in capacity credits

RC_2008_34 would amend the Market Rules so that the cost of Supplementary Capacity Contracts would be targeted at specific Market Participants, rather than being included in the Shared Reserve Capacity Cost that would be met by Market Customers, where:

- a Facility fails a second reserve capacity test and the IMO reduces the number of reserve capacity credits held by the Market Participant for that Facility (existing Market Rule 4.25.4); or
- a Market Participant applies for a reduction in the number of reserve capacity credits held by the Market Participant for a Facility (existing Market Rule 4.25.4C).

In either of these cases, the reduction in a Facility's capacity credits would appear to be based on the inability of the Facility to provide the level of capacity for which it had been certified. This would appear to be most likely the result of design and/or operational constraints that are best managed by the Market Participant that owns and/or controls the Facility in question (that is, the Market Generator rather than the Market Customer).

Other than the submission from Verve Energy (Verve), the IMO's Draft Rule Report indicates that all other submissions supported this element of RC_2008_34.

Verve claimed that where a Market Generator has its capacity credits reduced, Market Customers would receive a benefit through lower Individual Reserve Capacity Requirements (IRCR) and/or excess capacity costs. It claimed that these benefits would be more than adequate compensation and that the additional targeted costs proposed by the rule change are not justified.

Alinta does not agree with this assessment. Firstly, the scenario envisaged by Verve would require that there was excess reserve capacity in the market and that the reduction in capacity credits did not immediately trigger a requirement for SRC (that is, there remained excess reserve capacity in the market after the reduction in a Facility's reserve capacity).

(It is noted that in this case, the Market Generator would also not immediately incur SRC costs. If a subsequent event triggered a requirement for SRC, RC_2008_34 would result in the Market Generator being required to meet the cost of funding SRC only to the extent that the reduction in capacity credits resulted in the requirement for SRC. To the extent that SRC was not immediately required following the reduction in capacity credits, it is clear that the Market Generator would incur less than 100 per cent of SRC costs, even ignoring the cap set equivalent to the annual reserve capacity payments.)

Secondly, Market Customers in the Western Australian electricity market generally bilaterally contract for capacity, so even in a scenario where there was excess reserve capacity, it is likely that only one Market Customer (or a small number) would be directly affected by the reduction in capacity from a Facility. Given an illiquid capacity credit market, the outcome envisaged by Verve would require that the affected Market Customer(s) then bilaterally contract with multiple other Market Customers to secure the required replacement capacity credits. This would require the affected Market Customer(s) to secure relatively small number of capacity credits from every other Market Customer. Given transaction costs and differing views as to the 'value' of capacity credits (which would affect expectations of 'acceptable' prices), it is unclear whether the adjustment in the distribution of capacity credits, and hence capacity costs, implied by Verve's scenario would eventuate. Alinta considers it more probable that affected Market Customers would in the short run be required to 'purchase' any shortfall in capacity credits from the IMO at the administered price, thus increasing overall market costs.

It is therefore more probable that a reduction in a Facility's capacity credits would not result in a reduction in costs incurred by Market Customers. It is highly unlikely that Market Customers would benefit from any form of (direct or in-direct) 'compensation'.

On this basis, and given the previous support of other submitters, Alinta considers that the Market Rules should be amended so that the cost of Supplementary Capacity Contracts are targeted at specific Market Participants where:

- a Facility fails a second reserve capacity test and the IMO reduces the number of reserve capacity credits held by the Market Participant for that Facility; or
- a Market Participant applies for a reduction in the number of reserve capacity credits held by the Market Participant for a Facility.

Extended Forced Outage

Alinta accepts that the exposure of Facilities to potential SRC costs as a result of RC_2008_34 in circumstances where the Facility was subject to an extended Forced Outage, including in circumstances were it was unable to be commissioned, would affect a project's risk profile. The IMO argued in its Draft Rule Change Report that RC_2008-34 would not apply to this reserve capacity year, and commented that it considered that sufficient notice had been provided to the market.

Nevertheless, Alinta acknowledges that there exist mechanisms within the Market Rules to incentivise Market Generators to ensure facilities are available to the market when required. For example, under Market Rule 4.26.1, all Facilities (including new Facilities that are unable to provide capacity to the market by 30 November) are liable to refund Capacity Credit payments for Forced Outages. Refund multipliers are highest in February and March, followed by December and January.[1]

Consequently, Alinta agrees that it would be appropriate to further consider whether the Market Rules should be amended so that the cost of Supplementary Capacity Contracts are targeted at a specific Market Participant where a Facility suffers an extended Forced Outage (proposed new Market Rule 4.28.4B).

Summary

Alinta considers that RC_2008_34 should be implemented to the extent it would amend the Market Rules so that the cost of Supplementary Capacity Contracts is targeted at specific Market Participants where:

- a Facility fails a second reserve capacity test and the IMO reduces the number of reserve capacity credits held by the Market Participant for that Facility (proposed new Market Rule 4.28.4A); or
- a Market Participant applies for a reduction in the number of reserve capacity credits held by the Market Participant for a Facility (proposed new Market Rule 4.28.4A).

At this time, Alinta considers that RC_2008_34 should not be implemented to the extent that it would amend the Market Rules so that the cost of Supplementary Capacity Contracts was targeted at a specific Market Participant where a Facility suffered an extended Forced Outage (proposed new Market Rule 4.28.4B).

Alinta does not support MMA's recommendation that RC_2008_34 not proceed in its entirety pending a broader review of the framework for SRC provision and the management of extreme capacity shortages on an economic basis.

[1] In aggregate, the total of any Capacity Credit refunds paid by a Market Participant to the IMO in any year is capped at the value of Capacity Credit payments received for that year. The value of Capacity Credit payments is established by assuming the IMO acquired all of the Capacity Credits held by the Market Participant at the Maximum Reserve Capacity Price, which is administratively determined.

imo Independent Market Operator

As a result, Alinta considers that proposed amending rules in the IMO'S Draft Rule Change Report (Section 8) should be further amended as follows (IMO added words are underlined and IMO deletions are shown with a strikethrough. Alinta added words are red underlined and IMO deletions are shown with a red strikethrough):

4.28.4. For each Trading Month, the IMO must calculate a Shared Reserve Capacity Cost being the sum of:

(a) the cost defined under clause 4.28.1(b); and

(aA) the net payments to be made by the IMO under Supplementary Capacity Contracts less:

(i) any amount drawn under a Reserve Capacity Security by the IMO and distributed in accordance with clause 4.13.11(a); less

(ii) any amount paid to the IMO in accordance with clause 4.28.4A; ~~less~~

~~(iii) any amount paid to the IMO in accordance with clause 4.28.4B; less~~

(b) the Capacity Cost Refunds for that Trading Month; less

(bA) the Intermittent Load Refunds for that Trading Month; less

(c) any amount drawn under a Reserve Capacity Security by the IMO and distributed in accordance with clause 4.13.11(b) and the IMO must allocate this total cost to Market Customers in proportion to each Market Customer's Individual Reserve Capacity Requirement.

4.28.4A. Where the number of Capacity Credits held by a Market Participant for a Facility have been reduced in accordance with clause 4.25.4 or 4.25.4C, the Market Participant must pay to the IMO, as compensation to the market, an amount:

(a) equal to the cost of funding Supplementary Capacity Contracts for any capacity shortfall stemming entirely from the reduced Capacity Credits not being available to the market; and

(b) not greater than the total value of the Capacity Credit payments associated with the reduced Capacity Credits that would have been paid to the relevant Market Participant for the 12 Trading Months commencing at the start of the Trading Day of the most recent 1 October, assuming the IMO acquires all of these Capacity Credits and the cost of each Capacity Credit so acquired is determined in accordance with clause 4.28.2(d).

~~4.28.4B. Where a Facility, including a new Facility, suffers an extended Forced Outage, the Market Participant holding Capacity Credits for that Facility must pay to the IMO, as compensation to the market, an amount:~~

~~(a) equal to the cost of funding Supplementary Capacity Contracts for any capacity shortfall stemming entirely from the capacity suffering the Forced Outage not being available to the market; and~~

~~(b) not greater than the total value of the Capacity Credit payments associated with the capacity experiencing the forced outage that are due to the relevant Market Participant for the 12 Trading Months commencing at the start of the Trading Day of the most recent 1 October, assuming the IMO acquires all of these Capacity Credits and the cost of each Capacity Credit so acquired is determined in accordance with clause 4.28.2(d).~~

~~For the purposes of this clause 4.28.4B, an extended Forced Outage is a Forced Outage that extends for a period of greater than one month in duration.~~

~~4.28.4C In respect of Demand Side Management for a Curtailable Load holding Capacity Credits, clauses 4.28.4C and 4.28.4B apply to the Facility and in respect of a Demand Side Programme, apply in respect of that Demand Side Program.~~

4.28.4.C For the avoidance of doubt, clause 4.28.4A applies:

(a) to a Facility holding Capacity Credits, in respect of Demand Side Management; and

(b) to a Demand Side Programme holding Capacity Credits.

4.28.4D For the purpose of clause~~s~~ 4.28.4A ~~and 4.28.4B~~, where there are a number of factors contributing to the expected amount of a shortfall determined in accordance with clause 4.24.1, the IMO must proportion the total cost of funding Supplementary Capacity Contracts (acquired by the IMO to address the shortfall) so that the amount paid by the Market Participant under clause 4.28.4A ~~or 4.28.4B~~ offsets only that portion of the total cost stemming entirely from the relevant capacity not being available.

2. Please provide an assessment whether the change will better facilitate the achievement of the Market Objectives.

Market Rule 2.4.2 states that 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 Wholesale Market Objectives are 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.

(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.

If RC_2008_34 is implemented to the extent it would amend the Market Rules so that the cost of Supplementary Capacity Contracts would be targeted at specific Market Participants where:

- a Facility fails a second reserve capacity test and the IMO reduces the number of reserve capacity credits held by the Market Participant for that Facility (proposed new Market Rule 4.28.4A); or
- a Market Participant applies for a reduction in the number of reserve capacity credits held by the Market Participant for a Facility (proposed new Market Rule 4.28.4A)

Alinta considers that the Market Rules, as proposed to be amended or replaced, would be consistent with the Wholesale Market Objectives.

Specifically, by targeting SRC costs as far as possible to those that cause the costs and are therefore best placed to manage the associated risk factors, the amended Market Rules would:

- be consistent with Market Objective (a), promoting the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system; and
- be consistent with Market Objective (d), minimise the long-term cost of electricity supplied to customers from the South West interconnected system

Alinta considers there is no evidence to suggest that the amended Market Rules would be inconsistent with Market Objectives (b), (c) and (e).

3. Please indicate if the proposed change will have any implications for your organisation (for example changes to your IT or business systems) and any costs involved in implementing these changes.

The changes to the Market Rules contemplated by RC_2008_34 would not require Alinta to change its IT or business systems, and hence there are no IT or business costs associated with the rule change proposal.

4. Please indicate the time required for your organisation to implement the change, should it be accepted as proposed.

The changes to the Market Rules contemplated by RC_2008_34 would not require Alinta to change its IT or business systems, and hence there is no specific period of time that would be required to implement the changes arising from the rule change proposal.