Independent Market Operator

Draft Rule Change Report
Title: Funding of SRC in the event of Capacity Credit cancellation

Ref: RC_2008_34

Standard Rule Change Process

Date: 20 March 2009

CONTENTS

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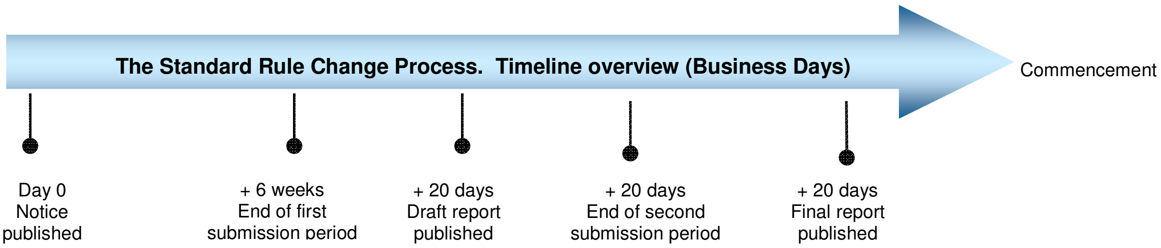
1. INTRODUCTION

On 2 October 2008 the Independent Market Operator (IMO) submitted a Rule Change Proposal regarding the amendment of clause 4.28.4 and the addition of new clauses 4.28.4A, 4.28.4B and 4.28.4C to 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:



The key dates for processing this Rule Change Proposal were extended in accordance with clause 2.5.10. Details of the extensions and the amended timeframes are provided in section 1.1.

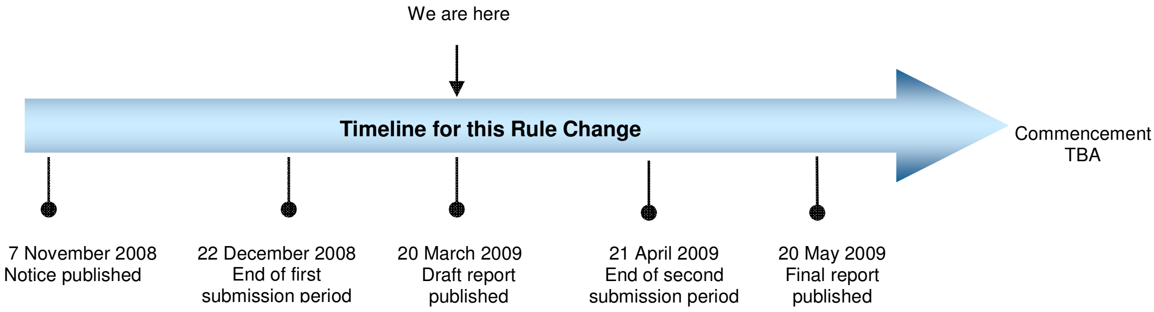
<u>1.1. Extension to Timeline</u>

<u>First Extension</u>
In accordance with clause 2.5.10 of the Wholesale Electricity Market Rules the IMO extended the timeframe within which to prepare and publish the draft report for this Rule Change Proposal from 16 January 2009 until 20 February 2009. A notice of this extension under clause 2.5.12 was published on the IMO website on 15 January 2009.

<u>Second Extension</u>
In accordance with clause 2.5.10 of the Wholesale Electricity Market Rules the IMO extended the timeframe within which to prepare and publish the draft report for this Rule Change Proposal for a second time, until 12 March 2009. The issues relating to this Rule Change Proposal had been the subject of considerable debate, particularly following RC_2008_27. To that end, the IMO commissioned McLennan Magasanik and Associates (MMA) to provide additional advice surrounding this rule change. In order to develop the best possible outcome for the market, further time was needed to assess the issues prior to publishing the Draft Rule Change Report. A notice of this extension under clause 2.5.12 was published on the IMO website on 20 February 2009.

<u>Third Extension</u>
In accordance with clause 2.5.10 of the Wholesale Electricity Market Rules the Independent Market Operator (IMO) extended the timeframe within which to prepare and publish the draft report for this Rule Change Proposal for a third time. Due to a delay in receiving the finalised report from MMA the IMO extended the timeframe until 20 March 2009.

The key dates in processing this Rule Change Proposal, as amended in the extension notices, are:



Based on the IMO's assessment of the Rule Change Proposal against the Market Objectives, the practicality and cost of implementing the proposal, the views of the Market Advisory Committee (MAC), the submissions received during the first submission period and the analysis conducted by MMA, the IMO's draft decision is to accept the Rule Change Proposal in the form outlined in section 8 of this Report.

This Draft Rule Change Report has been prepared by the IMO in accordance with clauses 2.7.6 and 2.7.7 of the Market Rules.

2. CALL FOR SECOND ROUND SUBMISSIONS

The IMO invites Market Participants to make submissions on this Draft Rule Change Report. The submission period is 20 Business Days from the publication date of this Report. Submissions must be delivered to the IMO by close of business on **Tuesday 21 April 2009.**

The IMO prefers to receive submissions by email to marketadmin@imowa.com.au using the submission form available on the IMO website: http://www.imowa.com.au/10_5_1_b_rule_change_proposal.htm

Submissions may also be sent to the IMO by fax or post, addressed to:

Independent Market Operator
Attn: Manager Market Administration and System Capacity
PO Box 7096
Cloisters Square, PERTH, WA 6850
Fax: (08) 9254 4399

3. THE RULE CHANGE PROPOSAL

3.1. Submission Details

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Address:	Level 3, Governor Stirling Tower, 197 St George's Terrace
Date submitted:	2 October 2008
Urgency:	*High*
Change Proposal title:	Funding of SRC in the event of capacity credit cancellation

3.2. Details of the Proposal

On 1 January 2009 RC_2008_27 (Funding of Supplementary Reserve Capacity) was implemented. This rule change removed the net payments to be made by the IMO under Supplementary Capacity Contracts from the Targeted Reserve Capacity Cost and included it as a component in the Shared Reserve Capacity Cost (SRCC).

The SRCC is the cost of Reserve Capacity to be shared amongst all Market Customers for the Trading Month. With the implementation of RC_2008_27 SRCC encapsulates the cost for funding Supplementary Capacity Contracts, that is, the cost for funding Supplementary Reserve Capacity (SRC).

The SRC Working Group (Working Group), which held its final meeting on 22 September 2008, resolved that additional changes would have to be implemented to the funding of Supplementary Capacity Contracts to address the objectives of the Market Rules.

The majority view of the Working Group was that if a Market Participant has its capacity credits reduced, which results in a shortfall and SRC is called, the cost of SRC should be targeted at the Market Participant that caused the shortfall. That is, the Market Participant should pay to the IMO compensation due to capacity credits not being available to the market [see proposed insertion of 4.28.4(aA)(ii)].

The proposed new Market Rule 4.28.4A stipulates how much a Market Participant must pay the IMO where the number of capacity credits held by that Market Participant for a facility has been reduced and caused the need for SRC. Market Rule 4.28.4A(a) specifies that the amount to be paid must equal the cost of funding Supplementary Capacity Contracts for the capacity shortfall stemming solely from the unavailability of the Market Participant's capacity credits. Market Rule 4.28.4A(b) limits the amount to the total value of capacity credit payments that would have been associated with the reduced capacity credits.

In addition, the Working Group resolved that a Market Participant holding capacity credits for a facility undergoing an extended forced outage should also recompense the market by an amount equal to the cost of funding Supplementary Capacity Contracts associated with a capacity shortfall brought on by the extended forced outage [see insertion of 4.28.4B(a)].

This would also include new facilities which are not fully commissioned by 30 November of the Relevant Capacity year and thus experience an extended forced outage until properly commissioned.

Market Rule 4.28.4B(b) limits this amount to half of the total value of capacity credit payments associated with the capacity experiencing the delay or the forced outage.

In the case where a number of factors have contributed to a capacity shortfall, new Market Rule 4.28.4C would require the IMO to proportion the total cost of funding the Supplementary Capacity Contracts in such a way that each relevant Market Participant only pays the portion which is attributable to its capacity being unavailable to the market.

3.3. The Proposal and the Wholesale Market Objectives

In the Rule Change Proposal the IMO submitted that this rule change would better address objective (a) of 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;

The IMO submitted that the proposal supported market objective (a) by promoting the economically efficient and reliable supply of electricity in the South West Interconnected System. This will be achieved by ensuring that:

- the cost of SRC is targeted at the participant that causes that cost, which is the participant that can best manage the risk of capacity not being available to the market when required; and
- the reliability of electricity supply is maintained by providing strong incentives for participants to apply for realistic capacity credit levels and commissioning schedules as part of their certification applications.

3.4. Amending Rules proposed by the IMO

In the Rule Change Proposal the IMO proposed the following amendments to the Market Rules (~~deleted words~~, <u>added words</u>):

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); <u>less</u>

<u>(ii) any amount paid to the IMO in accordance with clause 4.28.4B;</u> 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 half of 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).

4.28.4C. For the purpose of clauses 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.

3.5. 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 the Rule Change Notice on 7 November 2008.

4. FIRST SUBMISSION PERIOD

The first submission period for this Rule Change Proposal was between 10 November 2008 and 22 December 2008.

4.1. Submissions received

The IMO received five submissions on the Rule Change Proposal from:

- Alinta;
- Griffin Energy (Griffin);
- Landfill Gas and Power (LGP);
- Synergy; and
- Verve Energy (Verve)

The full text of each submission is available on the IMO website: http://www.imowa.com.au/Attachments/RuleChange/RuleChange_2008_34.html.

4.2. Submission from Alinta

Alinta supports the point of the amendments to the Market Rules that would result from RC_2008_34 in principle. However, Alinta considers that the proposed amendments require further consideration and that as currently worded they may not better contribute to the achievement of the market objectives. Alinta submits that in principle, when taken together, RC_2008_27 and RC_2008_34 are likely to better contribute to the achievement of market objectives (a) and (b), relating to efficiency and competition.

However, Alinta has suggested some amendments to clause 4.28.4A (a) (see relevant section below) and submit that if a consequential amendment is not made to the rule change, it may not better contribute to the achievement of the market objectives, in particular:

- Objective (c): The rule change may discourage retailers from offering Demand Side Management (DSM) products. Therefore may discriminate against particular energy options and technologies.
- Objective (d): If the rule change discourages retailers from offering DSM products the long term cost of electricity supplied to customers is unlikely to be minimised.

- Objective (e): the risk that retailers offering DSM products may be exposed to SRC costs, even when there is no net change in the number of Capacity Credits (CC) available may discourage retailers from offering DSM products, this may discourage the taking of measures to manage the amount of electricity used and when it is used.

Alinta considers that the guiding principle for allocation of costs should be to target those costs as far as possible to those that caused the costs and are therefore best placed to manage the associated risk factors. For this reason Alinta did not support RC_2008_27 as it considered that rule change in isolation would not better contribute to the achievement of the market objectives[1]. Alinta submits that RC_2008_34 would overcome the main shortcomings, as it would target costs at those directly responsible for the requirement to procure SRC.

Market Rule 4.28.4A and Demand Side Programmes

Under Market Rule 4.8.3, loads comprising DSM programmes are registered as a Curtailable Load, and the IMO is required to (individually) assign Certified Reserve Capacity and reserve capacity obligations to the Facilities. Alinta is concerned that under the proposed Market Rule 4.28.4A, the churn of a customer that is participating in a DSM programme, and is therefore registered as a Curtailable Load may expose a Market Participant to SRC costs even if the Market Participant registered an equivalent amount of new Curtailable Load to replace the amount of churned Curtailable Load (and the new relevant Facilities were assigned CRC and reserve capacity obligations by the IMO).

Under this scenario there would be no net change in the Curtailable Load or the number of Capacity Credits that the Market Participant is making available to the market, although the specific Facilities that provided those CC would have to be changed.

It is unclear whether under the proposed Market Rule 4.28.4A(a) the mere changing of loads that were registered as Curtailable Load could expose the Market Participant to potential SRC costs.

Alinta requests that the IMO consider that the proposed Market Rule 4.28.4A(a) be clarified to ensure that it does not expose a Market Participant to potential SRC costs as a result of the mere changing of Facilities providing the CC.

Market Rule 4.24.4B and the definition of an extended forced outage

Alinta submits that the proposed new Market Rule 4.24.4B refers to an “extended forced outage” which does not appear to be a defined term in the Market Rules (although the term is also used in Market Rule 4.12.2(d)). Alinta considers that, in order to provide clarity, the Market Rules should define when a “Forced Outage” (or multiple “Forced Outages”) constitutes an “extended forced outage”.

4.3. Submission from Griffin

Capacity Credit Reduction Scenario

Griffin agree that the rule change is warranted for the scenario where the Market Participant has its capacity credits reduced, which results in a shortfall and SRC is called, and the cost of SRC should be targeted at the Market Participant which caused the shortfall (proposed MR 4.28.4A). In this case, Griffin contends that it seems

[1] See Alinta’s submission for its comments on RC_2008_27, and the IMO’s Final Rule Change Paper for RC_2008_27 for the IMO’s response to these comments.

acceptable for these generators to incur some costs if SRC is called, as the fact an SRC event is being called must necessarily be attributed (at least in part) to the generator that has withdrawn what would be spare capacity from the market. In this respect, Griffin believes the rule change is warranted.

Forced Outage Scenario and impact against the Market Objectives

However Griffin Energy does not believe that the allocation of SRC costs to generators (including new generators) that undergo a forced outage is a sensible outcome for the market. The capacity refund mechanism is meant to offer incentives to generators to maintain reliability (in the form of penalties for forced outages). Allocating another cost to generators resulting from the same event (i.e. a forced outage) renders the current capacity refund mechanism redundant, as the price signals incorporated under the present regime are implicitly being altered by this proposed rule change. Griffin does not believe that allocating SRC costs to generators undergoing a forced outage will better facilitate any of the market objectives, and might negatively impact some:

(a) With regards to Market Objective (a) Griffin contends that this rule change will be unlikely to improve the reliable and/or safe production of electricity but will potentially lead to higher wholesale costs (or a loss of economic efficiency). This results from the manner in which the costs of SRC are met. New entrant generators will price in the cost of meeting SRC events whether they are triggered or not. This type of risk (which occurs periodically and is unlikely to be influenced by ex-ante action) is better managed by an ex-post allocation of costs. This rule change will incentivise ex-ante risk management and costs;

(b) Griffin notes that there is unlikely to be impacts on this objective, other than new entrant generation may tend to favour organisations with either a higher appetite for risk, or with the financial wherewithal to manage it (i.e. it may add a barrier to entry to smaller potential new generation entrants);

(c) Griffin posits that new entrant generation that is more likely to incur costs through late commissioning (i.e. capital intensive plant or new technology) are discriminated by this proposed rule change in that they are more likely to incur the SRC costs and more likely to require ex-ante risk financing;

(d) Griffin contends that (as set out in (a) above), the cost of wholesale electricity will increase without any resultant benefit to the SWIS.

4.4. Submission from Landfill Gas and Power

LGP supports the proposed Rule Change (conditional on the implementation of RC_2008_27) on the grounds that it more equitably allocates the costs of SRC to causers and thereby provides financial signals to motivate compliance with the intent of the Capacity Credit obligation. In the event of RC_2008_27 not being implemented, LGP advocates reconvening the SRC Working Group and reviewing all that group's outcomes.

LGP support the capping of the cost to the amount that would have been paid to a generator (or 50% in the case of an existing facility) had it been available as initially contracted.

LGP supports the IMO's contention that the proposal supports market objective (a) by allocating the costs of SRC to the causers and thereby motivating them to comply with their capacity contracts.

4.5. Submission from Synergy

Synergy supports the Rule Change Proposal. In its submission Synergy confirms, as the Chair of the Supplementary Reserve Capacity working group, that it was the majority view of that group that if a Market Participant has its capacity credits reduced, which results in a shortfall and Supplementary Reserve Capacity is called, the cost of that capacity should be targeted at that Market Participant. That is, the Market Participant should pay to the IMO compensation due to capacity credits not being available to the market.

Synergy accepts the IMO's view that the proposed rule change supports the operation of the Market Objectives.

In its submission Synergy stressed that the use of the SRC process has the potential to place a substantial financial burden on Market Customers and in turn, on their end-use customers. The original market design contemplated SRC as being a very rare event. Synergy therefore strongly supports a review (as outlined in RC_2008_28) following any call for SRC, which assesses the appropriateness of the SRC mechanism and seeks to make improvements for any future application of SRC.

Clause 4.28.4A
Consistent with the underlying causer pays principle, the proposed clause 4.28.4A stipulates how much a Market Participant must pay the IMO where the number of capacity credits held by that Market Participant for a facility has been reduced and caused the need for Supplementary Reserve Capacity. This clause effectively limits the amount to the total value of capacity credit payments that would have been associated with the reduced capacity credits.

Clause 4.24.4B
Synergy notes that this rule change extends the requirement to recompense the market for cancelation of capacity credits to those plants that are subject to an extended forced outage or delay. Synergy supports that in these instances the amount should be limited to half of the total value of capacity credit payments associated with the capacity experiencing the delay or the forced outage.

4.6. Submission from Verve

Verve does not support the Rule Change Proposal. Verve contends that the current Market Rules already provide adequate and significant incentives for participants to ensure their plant is made available to the market. They also provide market customers with significant revenue streams that can be used to offset the potential cost of SRC resulting from the unavailability of capacity. Verve considers the imposition of further penalties proposed under this rule change to be an unnecessary and punitive measure that is unlikely to reduce the occurrence of extended forced outages or capacity credit reductions.

Forced Outage Scenario
For a facility undergoing an extended forced outage, the relevant Market Participant is already required to pay Capacity Cost Refunds to the market, the proceeds of which are shared amongst Market Customers. These refund payments are significant in February and March when SRC is most likely to be required, and represent a substantial offsetting revenue stream for Market Customers should the forced outage contribute to the need for SRC.

Verve also considers the refund payments, combined with lost energy market revenue, out-of-merit generation costs and bilateral contract penalties, already provide sufficient incentive to ensure plant is made available to the market and that additional incentives are therefore not justified.

Capacity Credit Reduction Scenario

Similarly, Verve contends that in the case where a Market Generator has its capacity credit allocation reduced, Market Customers receive a benefit through lower Individual Reserve Capacity Requirements (IRCR) and/or excess capacity costs. Verve Energy considers this to be more than adequate compensation to the market and that the additional targeted costs proposed by the rule change are not justified.

Clause 4.28.4A and 4.28.4B

Verve believes that if the IMO decides to implement the rule change then the relevant SRC cost charged to the participant under clauses 4.28.4A(a) and 4.28.4B(a) should at least be reduced by the value of reserve capacity refunds or capacity credit reduction incurred, or expected to be incurred, in respect of the outage or reduction..

Verve Energy also believes consideration should be given to setting the upper limit for target SRC costs under clauses 4.28.4A (b) and 4.28.4B (b) at the same level. Both capacity reductions and extended forced outages are equally likely to contribute to the need for SRC and in both cases the offsetting cash flows received by market customers, being refund payments or IRCR reductions, are capped at the market value of the annual reserve capacity payment. It would therefore seem appropriate to set the limits on liability at the same level.

Clause 4.28.4C
Verve Energy is concerned that the determination of targeted SRC costs only considers a participant's contribution to the reserve capacity shortfall under clause 4.24.1. Verve believes consideration should be given to amending clause 4.28.4C such that availability-based SRC costs are allocated based on contribution to the expected shortfall under clause 4.24.1 while activation costs are allocated based on contributing factors in the relevant trading interval. This would also be more consistent with the broader market design consisting of separate capacity and energy markets.

Proposal against the Market Objectives
Market objective (a): Verve Energy agrees that the proposal provides strong incentives for participants to apply for realistic capacity credit levels and commissioning schedules. However it is the view of Verve Energy that sufficient incentives already exist and that the proposal is unlikely to improve system reliability. Furthermore, it may lead to inefficient production as customers have a reduced incentive to manage demand.

Verve considers the proposal will adversely impact objective (e) as market customers will have a reduced incentive to manage demand if SRC is procured solely as a result of a capacity credit reduction or extended forced outage.

4.7. Public Forums and Workshops

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

5. THE IMO'S ASSESSMENT

In preparing this Draft Rule Change Report, the IMO must assess the Rule Change Proposal in light of clauses 2.4.2 and 2.4.3 of the Market Rules. This is outlined in the following sections.

5.1 Wholesale Market Objectives

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 Market Rules as a whole, if amended, will be consistent with the Wholesale Market Objectives.

Wholesale Market Objective	Consistent with objective
(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system	Yes
(b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors	Yes
(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	Yes
(d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system	Yes
(e) to encourage the taking of measures to manage the amount of electricity used and when it is used	Yes

Further, the IMO considers that the proposed Amending Rules will have the following impact on how the Market Rules better address the Wholesale Market Objectives:

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

The IMO's assessment against market objective (a) 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 IMO submitted that the proposal supported market objective (a) by promoting the economically efficient and reliable supply of electricity in the South West Interconnected System. This will be achieved by ensuring that:

- the cost of SRC is targeted at the participant that causes that cost, which is the participant that can best manage the risk of capacity not being available to the market when required; and

- the reliability of electricity supply is maintained by providing strong incentives for participants to apply for realistic capacity credit levels and commissioning schedules as part of their certification applications.

5.2 Practicality and cost of implementation

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 may require changes to the Wholesale Electricity Market Systems operated by the IMO. These are currently being investigated by the IMO. Verve submits that minor system changes will be required to facilitate settlement reconciliation. Verve noted that costs are expected to be $1000-$2000. No other implementation costs have been identified to the Market.

Griffin noted that as a developer of significant generation facilities, this proposal will lead to higher working capital costs for future generation developments to meet potential SRC costs.

Griffin submitted that as a retailer, the proposal will reduce the exposure of their fixed bilateral contracts to SRC costs.

All Market Participants noted that they do not require any specific lead time to allow implementation of the proposal. However, Verve submitted that it expects sufficient time will be available to implement the change between commencement of the rule change and the occurrence of the relevant non-stem settlement.

5.3 Views expressed in submissions and IMO's response

In accordance with Clause 2.4.3(c) of the Market Rules, in deciding whether or not to make Amending Rules, the IMO must have regard to the views expressed in submissions on the Rule Change Proposal.

The response to the Draft Rule Change Report submitted by the IMO was mixed, as shown below.

	Alinta	Griffin	LGP	Synergy	Verve
Support	Yes, in principle. Consider that further clarifications required.	Partial support. Supported for the scenario where a participant has its capacity credits reduced, but not for forced outages.	Supported, conditional on the implementation of RC_2008_27.	Supported.	Does not agree with the rule change. It considers that the current penalties for capacity outages are sufficient compensation to Market Customers.

A number of issues were raised during the submission period. Below are the IMO's responses to each of the main issues identified in submissions during the first submission period:

Alternative option for funding SRC with respect to late commissioning or forced outage

- Griffin proposed the following alternative method which might be utilised to offset the costs of SRC in a predominantly bilateral market:

    - The IMO to distribute back to retailers only the proportion of the value of capacity credit refunds paid by generators which is equal to the proportion of energy sold in the market via the STEM or balancing mechanisms when the outage occurred; and
    - The balance of the refunds could be retained by the IMO to manage the risk of SRC, either by directly procuring supplementary capacity on an as-needed basis, or by increasing the reserve margin itself through directly contracting additional capacity.

  The IMO agrees with Griffin's submission in that structural reform such at this will likely take time to investigate and implement. The IMO notes that significant work was undertaken by the SRC Working Group to facilitate the outcomes and Rule Change Proposals 27, 28 and 34. The IMO does not consider it prudent to embark on a further review, especially one involving significant structural reform, so soon after the initial review has been undertaken. It is the IMO's opinion that this in itself would place undue regulatory risk on the Market and Market Participants.

  The IMO notes that there would be significant costs and increased complexity associated with Griffin's suggestion. In particular, the IMO notes that this was discussed at the SRC Working Group and there was no clear support for this proposal. The IMO notes that this type of mechanism and management of funds is complex to administer and there is a range of associated issues in respect to timing, particularly around Market Participants entering and exiting the market.

  The IMO also notes Griffin's concerns regarding the regulatory risk profile of the market and ensure that any new entrant generators that have already financed new projects are not subject to further (potential) regulatory cost increases. The IMO contends that that work of the SRC Working Group was largely complete by the third quarter of 2008 and that this rule change was never intended to be implemented this Reserve Capacity Year. The IMO believes this provides sufficient notice for this rule change and adequate signals have been provided.

Clause 4.28.4A

- Verve raised that the relevant SRC cost charged to the participant under clause 4.28.4A(a) should be reduced by the value of Capacity Cost Refunds or capacity credit reduction incurred, or expected to be incurred, in respect of the outage or reduction.

  The IMO notes that reducing the value of payments made to fund SRC costs using the conditions proposed by Verve may be contrary to the intent of the rule change, that is, to apportion costs where possible to those entities responsible for inducing the cost on the Market. Directly attributing the costs to those entities was the supported position of the SRC working group.

- Verve contended that the upper limit for target SRC costs under clause 4.28.4A (b) should be set at the same level as 4.28.4B (b).

  The IMO considers that the targeted SRC costs should be the same for both the extended forced outage scenario and for the Capacity Credit Reduction scenario. The IMO considers that there was no justifiable basis for capping the limit at 50% for the extended forced outage and therefore intends to set this at the same level as for the Capacity Credit Reduction scenario. That is, not greater than the total value of the Capacity Credit payments associated with the reduced CC that would have been paid to the relevant Market Participant. The IMO has contacted the Working Group member who suggested the 50% rate and confirmed their position.

- Alinta noted that consideration should be given to clarifying proposed Market Rule 4.28.4A (a) to ensure that it does not expose a Market Participant to potential SRC costs as a result of the mere changing of Facilities providing the CC associated with a Demand Side Programme (if an equivalent amount of new Curtailable Load is registered to replace the amount of churned Curtailable Load).

  To remove doubt, the IMO has clarified these provisions in respect of DSM in the subsequent amendments, presented in section 6 It is accepted that a DSM Programme which experiences churn, but for which the loads are not replaced will be subject to 4.28.4A and/or 4.28.4B and/or 4.28.4C as appropriate

Clause 4.28.4B

- Alinta noted that Market Rule 4.24.4B refers to an “extended forced outage” which is not a defined term in the Market Rules (although the term is also used in Market Rule 4.12.2(d)).

  The IMO notes that it has proposed subsequent amendments to define extended Forced Outages for the purposes of clause 4.24.4B. These amendments are included in section 6 of this report.

- Verve Energy raised that the relevant SRC cost charged to the participant under clause 4.28.4B(a) should be reduced by the value of Capacity Cost Refunds or capacity credit reduction incurred, or expected to be incurred, in respect of the outage or reduction).

  The IMO notes that reducing the value of payments made to fund SRC costs using the conditions proposed by Verve Energy may be contrary to the intent of the proposed rule change, that is, to apportion costs where possible to those entities responsible for inducing the cost on the Market. Directly attributing the costs to those entities was the supported position of the SRC working group.

- Griffin does not believe that allocating SRC costs to generators undergoing a forced outage will better facilitate any of the market objectives, and might negatively impact some.

  The IMO notes the SRC Working Group resolved, by a majority decision, that a Market Participant holding capacity credits for a facility undergoing a forced outage should recompense the market by an amount equal to the cost of funding

Supplementary Capacity Contracts associated with a capacity shortfall brought on by the extended forced outage. This would also include new facilities which are not fully commissioned by 30 November of the Relevant Capacity year and thus experience a forced outage until properly commissioned.

Clause 4.28.4C

- Verve contended that consideration should be given to amending clause 4.28.4C such that availability-based SRC costs are allocated based on contribution to the expected shortfall under clause 4.24.1 while activation costs are allocated based on contributing factors in the relevant trading interval. This would also be more consistent with the broader market design consisting of separate capacity and energy markets.

  The IMO considers that given the extensive consultation already conducted in respect of this issue, the introduction of these changes would not provide sufficient additional benefit over that already provided by the rule change proposal (as amended).

5.4 Views expressed by the MAC

In accordance with Clause 2.4.3(d) of the Market Rules, in deciding whether or not to make Amending Rules, the IMO must have regard to the views expressed by the Market Advisory Committee (MAC), where the MAC met to consider the Rule Change Proposal.

The Market Advisory Committee (MAC) discussed the proposed Rule Change at the 8 October 2008 meeting. At this meeting it was noted that this Rule Change proposal was borne out of the deliberations of the SRC Working Group. Following lengthy discussion the Working Group made the determination that if a Market Participant has its Capacity Credits reduced, which results in a shortfall and SRC is called, the cost of SRC should be targeted at the Market Participant which caused the shortfall. Following this discussion, MAC members agreed to progress the proposed Rule Change.

5.5 Technical Study

MMA were engaged to conduct an assessment of the proposed Rule Change and of the responses received through the first consultation period. A copy of MMAs assessment is available on the IMO's website: http://www.imowa.com.au/Attachments/RuleChange/RC_2008_34%20MMA%20submission%20-%2012%20March%202009.pdf

MMA identified a number of issues which it believes need to be addressed prior to progressing the proposed rule change. The issues identified by MMA are summarised below, together with actions taken by the IMO in respect of each issue:

- The use of the term "extended Forced Outage" is not defined, nor is it distinguished from the existing term "Forced Outage". It is not clear in the proposed Rule Change whether this is intended as a new and mutually exclusive class of forced outage;

  - Action Taken: The IMO has provided a definition of the term extended Forced Outage for the purposes of these provisions and made subsequent amendments in respect of clause 4.24.4B. These amendments are presented in section 6 of this report.

- A discount for extended Forced Outages was originally intended to remove perceived double counting of refunds which does not occur under the proposed Rule Change. The discount is not recommended because it would provide perverse incentives for generators to over-state the risks of future outages and delays so as to reduce their exposure to penalties. This would cause IMO to incur additional expenditure for SRC that would then not be fully required. This would impose additional costs on Market Customers.
    - Action Taken: The IMO has removed the discount provided in clause 4.28.4B. The IMO has held discussions with the original proposer of the discounting provisions and identified that the original basis for inclusion in the clause is unjustified. Clause 4.28.4B(b) has been modified with the amendments presented in section 6 of this report.
- Alinta's concern about the treatment of DSM resources associated with customer churn should be addressed in finalising the Rule Change. A transfer of a generation resource or a DSM resource among Market Participants under a DSM program should not give rise to a refund under Clauses 4.28.4 to 4C unless the DSM capability is disabled due to the transfer. In such a case the refund should be attributable to the retailer causing the disablement of the DSM capability.
    - Action Taken: The IMO has included an additional clause (now 4.28.4C) to remove doubt that Market Customers with Demand Side Programmes will not be exposed to SRC costs in respect of these programmes in the case that it has replaced loads that have churned.
- The proposed changes should be finalised and implemented before 1 May 2009 when Expressions of Interest are requested for the next Reserve Capacity Cycle.
    - Action Taken: The existing timeframes are sufficient so as to allow for the rule change to have been progressed before 1 May 2009 if it is ultimately approved.

The IMO considers it has addressed the main concerns identified by MMA through the further amendments presented in section 6 of this Draft Rule Change Report.

6. AMENDMENTS TO AMENDING RULES

Based on the recommendations of MMA in their assessment of the proposed rule change and in response to the issues raised during the first public submission period the IMO has made the following changes to the proposed Amending Rules (~~deleted words~~, <u>added words</u>):

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).

<u>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.</u>

<u>4.28.4C In respect of DSM for a Curtailable Load holding Capacity Credits, clauses 4.28.4B and 4.28.4C apply to the Facility and in respect of a Demand Side Programme, apply in respect of that Demand Side Program.</u>

4.28.4D For the purpose of clauses 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.

7. IMO'S DRAFT DECISION

The IMO's draft decision is to accept the proposed amendment of clause 4.28.4 and the addition of new clauses 4.28.4A, 4.28.4B, 4.28.4C and 4.28.4D to the Wholesale Electricity Market Rules as proposed in the Rule Change Proposal and amended in Section 6.

7.1 Reasons for the decision

The IMO has made its decision on the following basis:

- The Amending Rules:
  - Will allow the Market Rules to better address the Wholesale Market Objectives (a);
  - Are consistent with the remaining Wholesale Market Objectives;
  - Have the support of support of the MAC;

- Have the general support of the Supplementary Reserve Capacity Working; and
- The technical study conducted by MMA, which identified a number of issues, has been addressed in subsequent amendments.

The wording of the relevant Amending Rules is presented in section 8 of this Report.

8. PROPOSED AMENDING RULES

The IMO proposes to implement the following amendments to the Market Rules (added words are <u>underlined</u> and deletions are shown with a ~~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); <u>less</u>

(ii) <u>any amount paid to the IMO in accordance with clause 4.28.4A;</u> less

(iii) <u>any amount paid to the IMO in accordance with clause 4.28.4B; less</u>

(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.

<u>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:</u>

(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.

4.28.4D For the purpose of clauses 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.

9. 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:

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 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.