



Draft Rule Change Report
Title: Least cost determination of
ancillary service contracts

Ref: RC_2008_38
Standard Rule Change Process

Date: 12 March 2009

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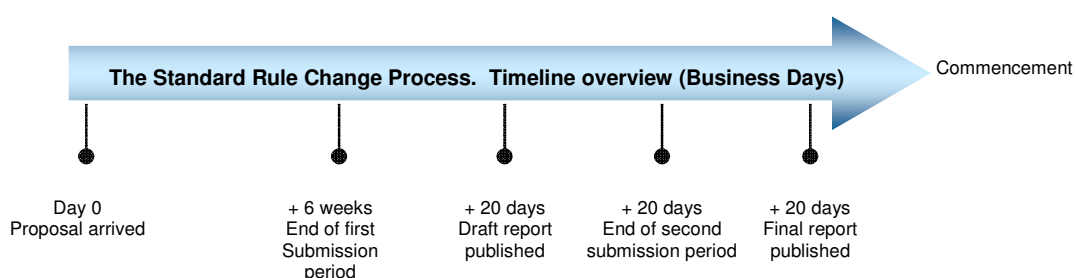
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1. INTRODUCTION

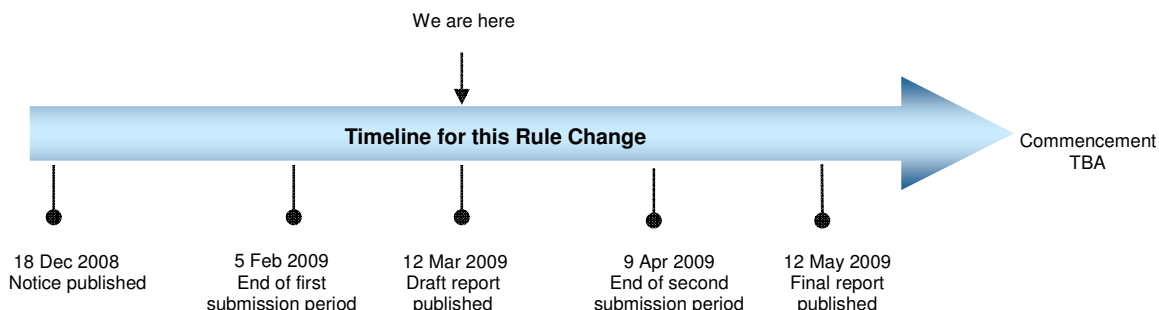
On 12 December 2008 System Management submitted a Rule Change Proposal regarding the addition of clause 3.11.8E and amendments to clause 6.17.6 in the Wholesale Electricity Market Rules (Market Rules).

This Proposal is being processed using the Standard Rule Change Process. Given the issues identified during the first submission period, the IMO decided it would be beneficial to conduct a public workshop prior to publishing the Draft Rule Change Report. Consequently, in accordance with clause 2.5.10 of the Market Rules, the IMO extended the timeframe to publish the Draft Rule Change Report to 12 March 2009.

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



The key dates in processing this Draft Rule Change Report, which are reflective of the aforementioned timeframe extension, are:



Based on the IMO's assessment of the Rule Change Proposal against the Wholesale Market Objectives, the practicality and cost of implementing the proposal, the submissions received during the first submission period, the views of the Market Advisory Committee (MAC) and the views expressed at the least cost determination of ancillary services workshop the IMO's draft decision is to accept the Rule Change Proposal in the form outlined in section 7 of this Report.

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

2. CALL FOR SECOND ROUND SUBMISSIONS

The IMO invites interested stakeholders 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 Thursday 9 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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Date submitted:	12 December 2008
Urgency:	High
Change Proposal title:	Least cost determination of ancillary service contracts

3.2 Details of the Proposal

Determination of 'Least Cost'

Market Rule 3.11.8 (b) indicates that System Management may only enter into an Ancillary Services contract for Spinning Reserve or Load Following with a Participant other than Verve Energy where the contract provides a less expensive alternative to Verve Energy (**Least Cost**). While there are many issues with this mechanism, the focus of this Rule Change relates to the determination of least cost.

Whilst MR 3.11.8 (b) requires System Management to determine Least Cost, it does not indicate a mechanism by which this can be achieved. Indeed, as currently drafted the obligation requires System Management to make certain assumptions, unassisted by a common information baseline, to determine commercial and economic outcomes for the market.

System Management proposed that Ancillary Service contracts for Spinning Reserve and Load Following be based on a proportion of Margin_Peak and Margin_Off-Peak.

These values are already used to determine the remuneration for Verve Energy for provision of these ancillary services and provide that a proportion of MCAP is used for the availability payment. In order to satisfy its obligations – and to satisfy the market that a spinning reserve or load following contract is genuinely least cost – a rule change is proposed to mandate that the availability component be based on a proportion of the Margin_Peak and Margin_Off-Peak values. Unless clause 3.11.8 (b) is altered, System Management will be unable to satisfactorily determine Least Cost, limiting the ability to competitively procure ancillary services.

Payment of energy provided under an Ancillary Service Contract

Market Rule 3.11.8 (b) indicates that System Management may only enter into an Ancillary Services contract for Spinning Reserve or Load Following with a Participant other than Verve Energy where the contract provides a less expensive alternative to Verve Energy. While there are many issues with this mechanism, the focus of this Rule Change relates to payment for energy provided under an Ancillary Service Contract.

The current Market Rules provide for the settlement of Ancillary Services based on the availability payment, whereas energy is settled separately. System Management does not propose to alter this arrangement, as it would introduce conflict with the Market Rules. Therefore, Ancillary Services Contracts will only cover the availability payment.

Verve Energy is remunerated for Spinning Reserve (which includes Load Following) via an availability payment and a payment for energy used. For Verve Energy, energy is paid for at MCAP, while energy payments for other Market Participant's would be at the Participant's pay-as-bid price. This price has the potential to represent a significant multiple of the MCAP price for the relevant period.

To determine whether another Participant can provide Spinning Reserve at a lower cost than Verve Energy, the energy payment must be on the same footing i.e. all energy must be settled at MCAP. Currently a comparison can not be made, as pay-as-bid prices can change daily.

For completeness, it is noted that as the Spinning Reserve time period finishes as detailed in MR 3.9.3, any additional energy requested after that time would be paid as a normal dispatch instruction (i.e. at the pay-as-bid price), assuming that the dispatch merit order necessitates calling upon that particular facility.

Proposed amendments

The intention of the proposed amendments is to resolve the above issues so as to allow for System Management to enter into an Ancillary Services contract for Spinning Reserve and Load Following, assuming that "least cost" is otherwise established.

In considering this proposal, it may be useful to note that all authorised energy payments receive MCAP, and that, when the SWIS requires System Restart, MCAP may be indeterminate. In proposing this change, System Management proposes an amendment to rectify a minor inconsistency within clause 6.17.6(b)(ii), which currently omits a correct reference sub-clause (iA).

3.3 The Proposal and the Wholesale Market Objectives

System Management submitted that this rule change would better address objective (a) of the Market Objectives. The changes as submitted would promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the SWIS.

It also purported that this rule change would better address objective (b) by increasing the certainty of the application of the rules, ensuring parity between Participants and aiding economically efficient outcomes.

3.4 Amending Rules proposed by System Management

System Management proposed the following amendments to the Market Rules (~~deleted words, added words~~):

3.11.8E For the purposes of clause 3.11.8, a contract must:

- (a) not include components for the payment of energy; and
- (b) only include components related to the availability of the service based on a proportion of the values determined under clause 3.13.3.

6.17.6. The Dispatch Instruction Payment, DIP(p,d,t), for Market Participant p and Trading Interval t of Trading Day d equals the sum of:

...

- (b) ...
 - ii. if paragraph (i) or (iA) does not apply, the amount for the Registered Facility is the product of:
 - 1. the qualifying quantity for Trading Interval t as calculated in accordance with clause 6.17.8, less the sum of the quantity indicated in the applicable Resource Plan (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity so that the result is measured at the Reference Node) for the Registered Facility for Trading Interval t and the Balancing Support Contract energy dispatched from the Facility in Trading Interval t as specified by System Management in accordance with clause 7.13(dA) (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity specified by System Management so that the result is measured at the Reference Node) and the Network Control Service Contract energy dispatched from the Facility in Trading Interval t as specified by System Management in accordance with clause 7.13(dB) (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity specified by System Management so that the result is measured at the Reference Node); and
 - ~~2. the applicable price as defined by clause 6.17.7 less MCAP for Trading Interval t.~~
 - 2. the price defined as:
 - i. the contracted price, if the Dispatch Instruction is for the purposes of an Ancillary Services Contract for System Restart, Dispatch Support or Load Rejection.
 - ii. zero, if the Dispatch Instruction is for the purposes of an Ancillary Services Contract other than for System Restart, Dispatch Support or Load Rejection, or

iii. the applicable price as defined by clause 6.17.7 less MCAP for Trading Interval t.

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.

The details of System Managements assessment of the Rule Change against the Market Objectives was published in the Rule Change Notice on 18 December 2008.

4. FIRST SUBMISSION PERIOD

The first submission period for this Rule Change Proposal was between 18 December 2008 and 5 February 2009.

4.1 Submissions received

The IMO received submissions on the Rule Change Proposal from Landfill Gas and Power (LGP) and Alinta. The details of the submissions received during the first submission period and the outcomes from any discussions of the proposal at public forums and workshops are summarised below. The full text of the public submissions is available on the IMO website

4.1.1 Submission from Landfill Gas and Power

LGP supports the Rule Change on the grounds that it standardises price offerings for spinning reserve and load following in order to permit determination of least cost by direct comparison without the need for subjective assumptions. LGP also supports the use of the existing structure by which Verve Energy is currently paid as the standard.

LGP also supports System Managements contention that the proposal supports market objectives (a) and (b).

4.1.2 Submission from Alinta

Alinta submitted that if the underlying intent of the rule change is to more effectively support future competitive tendering for these Ancillary Services it is unclear whether such an outcome would be better facilitated. In particular, Alinta noted that:

- The rule change fails to clearly identify the basis on which availability payments for Spinning Reserve or Load Following Ancillary Services would be determined. This is because the Market Rules do not clearly identify the basis on which availability payments are determined at the moment.
- The rule change fails to improve the certainty required by Rule Participants in order to make a rational economic decision to provide Spinning Reserve and Load Following Ancillary Services. In particular, whilst under the proposed rule

change Verve and Rule Participants would be both paid at MCAP, there would still be no assurance as to the value they would be paid at for providing ancillary services. This is because it is not possible to forecast MCAP with any degree of certainty.

- Furthermore, whilst Verve is currently paid at MCAP, it is mandated to provide the services to balance the market which means it is not required to make an economic decision to provide ancillary services. However, other Rule Participants are not obliged to provide Ancillary Services and given there is no certainty surrounding its level of payment then it may be that the rational economic decision for a Generator would be to not bid into this Market.
- Alinta submitted that if the underlying intent of the Rule Change Proposal was to support the emergence of a competitive market for ancillary services a more comprehensive review should be undertaken. Alinta was ultimately uncertain whether the proposed changes would better facilitate the support of future competitive tendering for Ancillary Services as it did not feel the proposal went far enough to address some of underlying issues they had identified with the current mechanism.

For these reasons Alinta submitted that it is unclear that there are benefits associated with this rule change other than at the margin for System Management.

4.2 Public Forums and Workshops

In response to the mixed views expressed in the submissions received during the first round of public consultation the IMO extended the timeframe for preparing the Draft Rule Change Report. The IMO held a public workshop on 27 February 2009 to review the issues raised.

The Workshop was attended by a range of Market Participants:

- Alinta
- Economic Regulation Authority
- Griffin Energy
- IMO
- Landfill Gas and Power
- NewGen
- Office of Energy
- Perth Energy
- Synergy
- Sinclair Knight Merz
- System Management
- Verve Energy

The workshop demonstrated a high level of engagement from industry and in particular provided a forum for System Management to put forward their reasons for proposing the rule change and participant's views to be heard and queries to be addressed, if appropriate.

The following points represent the agreed outcomes from the discussions held (the full workshop minutes are available on the IMO website: http://www.imowa.com.au/Attachments/RuleChange/RuleChange_2008_38.html):

- The current design of the process for procuring ancillary services is less than ideal and so a detailed review of the procurement of ancillary services should be undertaken.

- System Management to investigate whether issue of determining least cost alternatives to supply ancillary services could be dealt outside the Market Rules, e.g. via contractual means.
- If a contractual option to improve the current situation is not available, the rule change in its current form should be progressed as this still represents an improvement to the status quo and will allow System Management to test whether the ancillary services procurement process works.

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 Market Rules if amended would not only be consistent with the Wholesale Market Objectives but also allow the Market Rules to better address the Wholesale Market Objectives:

Impact	Wholesale Market Objectives
Allow the Market Rules to better address objective	a, b, d
Consistent with objective	c, 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 proposed rule change supports this objective by removing a current inefficiency in the valuation of ancillary service options provided by differing parties, which has been created by the Market Rules. In particular, the differing energy payments to Verve Energy and other potential service providers, as created under the current Market Rules, means that, as contended by System Management, it may not currently be able to make an economically efficient decision when assessing whether an alternative service provider would supply a less expensive ancillary services alternative to Verve. By correcting this in the Market Rules ancillary service contracts may be able to be better allocated to achieve maximum net benefit to the market.

The IMO's assessment against market objective (b) is as follows:

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

The proposed rule change supports this market objective by ensuring parity between participants for the energy payments associated with providing ancillary services. This allows potential service providers to compete on an equal footing by removing a possible barrier to enter into the ancillary services market. This will potentially act to encourage competition among providers of ancillary services. However, it should be noted that there may be other barriers to entry that need addressing to further facilitate the efficient entry of new competitors and encourage competition.

The IMO's assessment against market objective (d) is as follows:

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

The proposed rule change supports this market objective by providing a more explicit mechanism for determining the least cost option for ancillary service procurement. This may improve the competitiveness associated with this process, which should act to minimise the long term cost of ancillary services.

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. No other costs have been identified to the Market.

5.3 Views expressed in submissions and the public workshop

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 IMO received mixed responses to the invitation for submissions for the Rule Change Proposal. In particular, LGP was supportive of the proposal on the grounds that the rule change would remove the need for subjective assumptions when determining least cost. However, Alinta considered that in its current form the proposal should not be progressed. In particular, Alinta submitted that if the underlying intent of the Rule Change Proposal was to support the emergence of a competitive market for ancillary services a more comprehensive review should be undertaken. Alinta was ultimately uncertain whether the proposed changes would better facilitate the support of future competitive tendering for Ancillary Services as it did not feel the proposal went far enough to address some of underlying issues they had identified with the current mechanism.

The IMO notes that in its submission Alinta did not express any direct concerns with the proposal, but rather expressed concern that the proposed changes were not extensive enough and that competition in the Ancillary Services market may not be enhanced given Alinta's other areas of concern. The IMO agreed that the issues raised by Alinta required addressing and so, on recommendation by the IMO Board extended the original Rule Change Proposal timeframe, held a public workshop on 27 February 2009.

Alinta's concerns that the proposed rule change was not addressing the underlying problems associated with process were also echoed at the public workshop by other attendees. The IMO agrees with the decision of the public workshop that there is merit in undertaking a more comprehensive review of the overall ancillary service mechanism in the future. To that end will place it on the Rule Participant issues register for prioritisation by the MAC.

It was agreed at the public workshop that if a contractual option to improve the current situation is feasible the rule change in its current form should be progressed as this still represents an improvement to the status quo and will allow System Management to test the ancillary services procurement process. System Management sought legal advice on the feasibility of a contractual solution, and have subsequently advised the IMO that its legal advice indicates that a rule change would present greater certainty, and certainly less risk all round, than attempting to include the "least cost" constraints within the contractual framework.

5.4 Market Advisory Committee

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 MAC discussed the proposed rule changes at its meeting on 10 December 2008.

The pre-rule change discussion paper presented by System Management intended to bring the issue of competitive procurement of ancillary services to the attention of the MAC. System Management noted that they are actively looking at ways to facilitate competitive procurement. The MAC agreed that the rule change should be progressed via the standard rule change process.

5.5 Additional Amendments

During the first public submission period the IMO considered that some changes to the proposed Amending Rules were required to improve the drafting and to clarify the requirements for a contract. These changes are as follows (~~deleted words~~, added words):

3.11.8E The scope of any Ancillary Services Contract entered into by System Management ~~For the purposes of clause 3.11.8, a contract must:~~

- (a) not include components for the payment of energy; and
- (b) only include ~~components related to~~ the availability of the service based on a proportion of the values determined under clause 3.13.3.

6.17.6. The Dispatch Instruction Payment, $DIP(p,d,t)$, for Market Participant p and Trading Interval t of Trading Day d equals the sum of:

...

(b) ...

ii. if neither paragraph (i) nor (iA) applies ~~does not apply~~, the amount for the Registered Facility is the product of:

1. the qualifying quantity for Trading Interval t as calculated in accordance with clause 6.17.8, less the sum of the quantity indicated in the applicable Resource Plan (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity so that the result is measured at the Reference Node) for the Registered Facility for Trading Interval t and the Balancing Support Contract energy dispatched from the Facility in Trading Interval t as specified by System Management in accordance with clause 7.13(dA) (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity specified by System Management so that the result is measured at the Reference Node) and the Network Control Service Contract energy dispatched from the Facility in Trading Interval t as specified by System Management in accordance with clause 7.13(dB) (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity specified by System Management so that the result is measured at the Reference Node); and

2. the price defined as:

i. the contracted price, if the Dispatch Instruction is for the purposes of an Ancillary Services Contract for System Restart, Dispatch Support or Load Rejection.

ii. zero, if the Dispatch Instruction is for the purposes of an Ancillary Services Contract other than for System Restart, Dispatch Support or Load Rejection, or

iii. the applicable price as defined by clause 6.17.7 less MCAP for Trading Interval t .

6. THE IMO'S DRAFT DECISION

The IMO's draft decision is to accept the proposed addition of clause 3.11.8E and amendments to clause 6.17.6 to the Wholesale Electricity Market Rules as proposed in the Rule Change Proposal and amended in section 5.3.

6.1 *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), (b), and (d);
 - Are consistent with the remaining Wholesale Market Objectives;
 - Have the support of the MAC; and
 - Have the support of the attendees of the public workshop (in the sense that this still represents an improvement to the status quo and will allow System Management to test the ancillary services procurement process).
- The IMO believes that, given the discussion at the public workshop of the issues highlighted during the first public consultation period and the consequent outcomes, the proposed rule change provides a substantive enough improvement to the current mechanism to justify accepting the Draft Rule Change Proposal in its current form at this stage.

Additional detail outlining the analysis behind the IMO's reasons is outlined in section 5 of this Draft Rule Change Report.

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

7. PROPOSED AMENDING RULES

The IMO proposes to implement the following amendments to the Market Rules (added words are underlined and deletions are shown with a ~~strikethrough~~):

3.11.8E The scope of any Ancillary Services Contract entered into by System Management for the purposes of clause 3.11.8 must:

- (a) not include components for the payment of energy; and
- (b) only include the availability of the service based on a proportion of the values determined under clause 3.13.3.

6.17.6. The Dispatch Instruction Payment, $DIP(p,d,t)$, for Market Participant p and Trading Interval t of Trading Day d equals the sum of:

...

(b) ...

ii. if neither paragraph (i) nor (iA) applies ~~does not apply~~, the amount for the Registered Facility is the product of:

1. the qualifying quantity for Trading Interval t as calculated in accordance with clause 6.17.8, less the sum of the quantity indicated in the applicable Resource Plan (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity so that the result is measured at the Reference Node) for the Registered Facility for Trading Interval t and the Balancing Support Contract energy dispatched from the Facility in Trading Interval t as specified by System Management in accordance with clause 7.13(dA) (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity specified by System Management so that the result is measured at the Reference Node) and the Network Control Service Contract energy dispatched from the Facility in Trading Interval t as specified by System Management in accordance with clause 7.13(dB) (where for the purpose of this calculation a Loss Factor adjustment is to be applied to the quantity specified by System Management so that the result is measured at the Reference Node); and

~~2. the applicable price as defined by clause 6.17.7 less MCAP for Trading Interval t .~~

2. the price defined as:

i. the contracted price, if the Dispatch Instruction is for the purposes of an Ancillary Services Contract for System Restart, Dispatch Support or Load Rejection.

ii. zero, if the Dispatch Instruction is for the purposes of an Ancillary Services Contract other than for System Restart, Dispatch Support or Load Rejection, or

iii. the applicable price as defined by clause 6.17.7 less MCAP for Trading Interval t .

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:

Public Domain

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