



Draft Rule Change Report
Title: Under Construction for the
Reserve Capacity Mechanism

Ref: RC_2009_07
Standard Rule Change Process

Date: 25 May 2009

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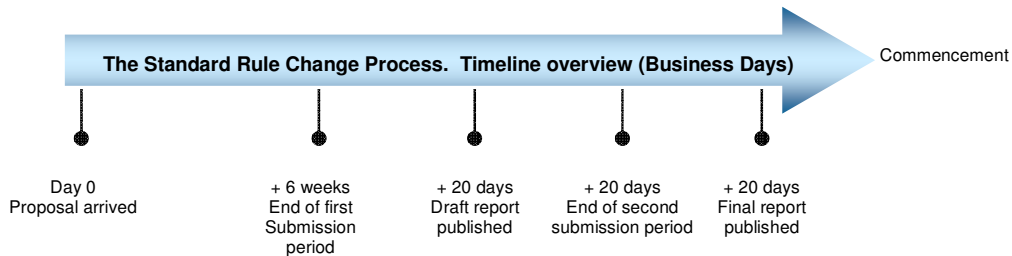
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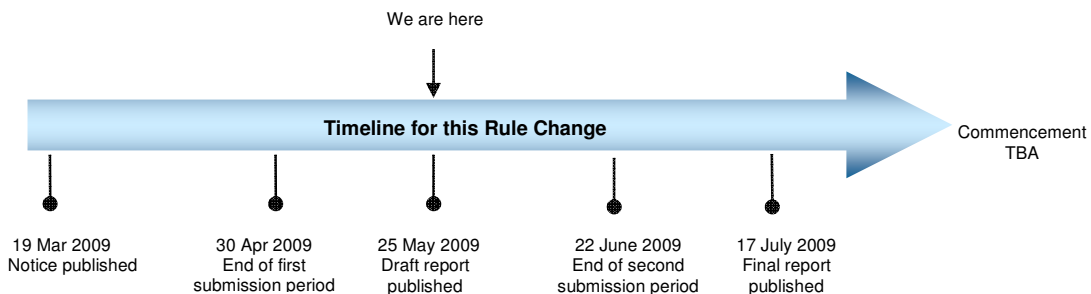
1. INTRODUCTION

On 16 February 2009 the Independent Market Operator (IMO) submitted a Rule Change Proposal regarding changes to clauses 4.2.7, 4.14.6 and Appendix 3 of the Wholesale Electricity Market Rules (Market Rules).

This Proposal is being processed using the Standard Rule Change Process. The standard process adheres to the following timelines, described in section 2.7 of the Market Rules:



The key dates in processing this Rule Change Proposal 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 and the views of the Market Advisory Committee (MAC) 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 **Monday 22 June 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:	17 March 2009
Urgency:	Medium
Change Proposal title:	Under Construction for the Reserve Capacity Mechanism
Market Rule(s) affected:	4.2.7, 4.14.6 and Appendix 3

3.2 Details of the Proposal

A key objective for the Wholesale Electricity Market is to ensure that electricity is provided reliably as well as economically. This is a particularly significant issue in Western Australia because the electricity system is isolated and supplies cannot be drawn from neighbouring systems.

Reliability is achieved through the Reserve Capacity Mechanism (RCM). This is a set of processes through which the IMO determines the amount of generation and demand side management capacity required to meet future demand and facilitates the provision of this to the market.

The reliability of the SWIS depends on generators and DSM providers actually delivering the capacity that they have offered. The IMO undertakes a process of certification through which it satisfies itself that, among other things:

- The Facility will be able to deliver the quantity of capacity that is being offered; and
- If the Facility is yet to enter service, that it will be able to supply power into the SWIS by the date claimed.

Facilities that are certified may apply to the IMO for Capacity Credits. The IMO assigns Capacity Credits following the priority rules set out in Appendix 3 of the Market Rules. In assigning Capacity Credits to Facilities under the RCM, the IMO must make a determination of the status of a Facility. In the case of Facilities yet to enter service, a Facility may be in either *proposed* status or *under construction*. It has been found that

the term *under construction* may not be optimal or broad enough for the full range of projects being considered or may be considered in the future.

Under construction implies the Facility is in the process of physically being constructed. Facilities with short lead times may be constructed within 12 - 18 months, for example, and would not be under construction two years in advance of the start of the relevant Capacity Year when the IMO assigns Capacity Credits.

Another example is a Market Participant seeking Certified Reserve Capacity (CRC) and Capacity Credits for a Facility upgrade. Construction in this case is not necessarily required, only the ability for the relevant participant to complete the upgrade during planned maintenance periods. Although these Facilities are fully committed at the time of application and in all other ways able to qualify for Capacity Credit assignment, a broader definition of this class is warranted.

In its Rule Change Proposal the IMO submitted to amend the Market Rules and replace the word *under construction* with *committed*. The assessment criteria to enable the IMO to determine whether a Facility is *committed* will be included in the Market Procedure for Declaration of Bilateral Trades and the Reserve Capacity Auction. Given this it should still be noted that there are a number of factors the IMO will need to take into account when undertaking its assessment. The definition of *committed* (changes from the current definition of *under construction* are underlined) is proposed to be:

Factors which will be taken into consideration when assessing whether a project is 'Committed' include:

- *Financial commitment by the Rule Participant to the primary equipment supplier. (This would usually take the form of a signed contract indicating purchase of the main plant equipment including penalty clauses associated with non-compliance of the purchase agreement).*
- *Formal commitment, including financial approval, on behalf of the company in respect of the project, for example Board approval;*
- *Details of planning, construction and environmental applications, approvals and licences;*
- *Access to land either through ownership or an appropriate leasing agreement;*
- *A signed contract for civil works (or appropriate alternative), including contractual delivery times, which indicate the construction phase has started; and*
- *Where a facility is being built primarily to supply energy to one or more foundation customers, evidence that relevant power supply contracts are in place.*

The proposed changes will help to remove any uncertainty around the order which offers for Capacity Credits relating to these projects will be accepted in Appendix 3 of the Market Rules.

3.3 The Proposal and the Wholesale Market Objectives

The IMO submitted that the proposed changes, which replace the term “*under construction*” with “*committed*”, will support Market Objective (c) by allowing committed projects with lead times of under two years (for which construction has not begun at the

time of application) for example small diesel generators, to be assigned Capacity Credits under step 2A in Appendix 3 of the Market Rules.

The IMO considers that the proposal is consistent with the other market objectives.

3.4 Amending Rules proposed by IMO

The amendments to the Market Rules proposed by the IMO are outlined below (added text, ~~deleted text~~):

- 4.2.7. By the date and time specified in clause 4.1.6, the IMO must publish the following information:
- (a) the number of Expression of Interests received;
 - (b) based on the Expression of Interests, the additional Reserve Capacity potentially available, categorised as:
 - i. capacity associated with Facilities that are ~~under construction~~ committed; and
 - ii. capacity associated with Facilities that are yet to commence being constructed, where this capacity is to be further categorised between new Facilities for which:
 - 1. an offer by the relevant Network Operator to enter into an Arrangement for Access (“**Access Offer**”) has been made and all necessary Environmental Approvals granted;
 - 2. applications for both Access Offers and Environmental Approvals have been made and one or both are being processed;
 - 3. no Access Offer has been applied for or some or all Environmental Approvals have not been applied for;
- ...
- 4.14.6. If two or more Facilities cannot simultaneously exist (for example, because more than one Market Participant is proposing to build a Facility that will be located at the same site,) then the IMO cannot accept a non-zero value provided in accordance with clause 4.14.1(c) in respect of more than one of these Facilities and must reject all but one Facility based on the following criteria:
- (a) Facilities that are operational or are ~~under construction~~ committed will be accepted ahead of other Facilities; then
 - (b) if more than one Facility remains, then Facilities that can demonstrate having secured financing will be accepted ahead of other Facilities; then

- (c) if more than one Facility remains, then Facilities with the greatest quantity of Certified Reserve Capacity will be accepted ahead of Facilities with lower Certified Reserve Capacity; then

...

Appendix 3: Reserve Capacity Auction & Trade Methodology

...

The algorithm is as follows:

Step 1: Start with $a = 1$

Step 2: Let the set of active offers comprise all offers from Availability Class “a”.

Step 2A: In the case of bilateral trade offers, accept offers from operating facilities and committed facilities ~~under construction~~ and remove them from the set of active offers.

Step 3: Accept offers from the set of active offers in order of

- In the case of testing bilateral schedules, decreasing availability.
- In the case of the reserve capacity auction, increasing price

until the capacity requirements of Availability Class “a” are fully covered or until there are no offers left unaccepted in the set of active offers.

Where two or more offers are tied with respect to the selection criteria such that accepting all but one of them would result in the total capacity selected exceeding the total capacity requirement of the Availability Class then the tied offers are to be accepted according to the following rules until the tie is resolved.

- In the case of the reserve capacity auction, offers from operating facilities and committed facilities ~~under construction~~ are to be accepted ahead of facilities that are not committed ~~yet to commence construction~~; then
- Offers are to be accepted in decreasing order of capacity offered; then
- Offers for capacity that was included in an Expression of Interest are to be accepted ahead of capacity that was not; then
- Offers are to be accepted in the order of the time the offers were received, with the earlier offer being taken first; and then
- Offers are to be accepted in the order the capacity secured Certified Reserve Capacity;

...

Step 11: End.

In the case of the auction only:

- While leaving the Reserve Capacity Price unchanged, the IMO must exchange one or more offers not accepted for one or more offers accepted in the auction if
 - the total capacity scheduled in the auction exceeds the Reserve Capacity Auction Requirement by more than 100 MW;
 - the Reserve Capacity Price exceeds zero,
 - the exchange produces the maximum possible reduction in the total value of offers accepted;
 - the exchange does not create an overall Reserve Capacity shortfall where none existed;
 - in the event that a capacity shortfall exists in one or more Availability Classes, the exchange will not shift a shortfall from an Availability Class with low availability to an Availability Class with high availability; and
 - this would not result in an existing facility, or a committed facility ~~under construction~~ being excluded.

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.

4. FIRST SUBMISSION PERIOD

The first submission period for this Rule Change Proposal was between 19 March 2009 and 30 April 2009.

4.1 Submissions received

The IMO received submissions on the Rule Change Proposal from Alinta, Landfill Gas & Power (LGP), Perth Energy and Verve Energy during the first submission period. Each submission received is summarised below. The full submissions received are available on the IMO website.

4.1.1 Submission from Alinta

Alinta supports the Rule Change Proposal on the grounds that will remove the implicit discrimination against Facilities and capacity expansions with short lead times (i.e. not needing to be physically under construction two years in advance of the start of the relevant Capacity Year) in the Market Rules.

Alinta supports the rule change on the grounds that it is likely to be consistent with market objectives (a), (b), (c) and (d), and it is not likely to be inconsistent with market objective (e).

Alinta suggested a possible change to the proposed Amending Rules in Market Rule clause 4.2.7(b) ii to replace “yet to commence being constructed” with “not committed”.

4.1.2 Submission from LGP

LGP supports the Rule Change Proposal on the grounds that requiring facility “commitment” as a pre-condition for the allocation of capacity credits is more reasonable and appropriate than requiring the facility be “under construction”.

LGP supports the IMO’s contention that the Rule Change promotes Market Objective (c) (*to avoid discrimination in that market against particular energy options and Technologies*) and is otherwise consistent with the other objectives.

Further, LGP considers that market objective (a) (*to promote the economically efficient, safe and reliable production and supply of Electricity*) is enhanced as the Rule Change Proposal removes the requirement that financiers would otherwise have to accept unnecessarily increased risk via the fact that they must start constructing a project that, at the point of commencement, does not actually create Capacity Credits.

4.1.3 Submission from Perth Energy

Perth Energy supports the Rule Change Proposal on the grounds that the process of developing a new project has many stages and a developer will have made very substantial commitments well before construction actually takes place. Perth Energy also supports the IMO’s contention that some projects take considerably less than two years so construction may not have commenced at the time that certification and Capacity Credits are sought and that this is particularly true for gas turbine, small renewable and plant upgrades.

Perth Energy anticipates that there may be some disagreement over what constitutes a facility being “committed” and as every project is different, that the IMO will need some leeway to make its own determination on whether a project is really committed or not.

Perth Energy suggested a possible change for consistency to the proposed Amending Rules in Market Rule clause 4.2.7(b) to replace “yet to commence being constructed” with “not yet committed”.

4.1.4 Submission from Verve Energy

Verve Energy supports the Rule Change Proposal on the grounds that the present rule favours long lead time plant that is “under construction” compared to short lead time plant that may be as equally committed. Verve Energy contends that the proposed changes will reduce this discrimination.

Verve Energy also supports the rule change will help with the achievement of market objective (c).

4.2 Public Forums and Workshops

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

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.

Market Rule 2.4.2 outlines 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”.

Additionally, clause 2.4.3 states, when deciding whether to make Amending Rules, the IMO must have regard to the following:

- Any applicable policy direction from the Minister regarding the development of the market;
- The practicality and cost of implementing the proposal;
- The views expressed in submissions and by the MAC; and
- Any technical studies that the IMO considers necessary to assist in assessing the Rule Change Proposal.

The IMO notes that there has not been any applicable policy direction from the Minister in respect of this Rule Change Proposal.

This IMO's assessment is outlined in the following sections.

5.1 Wholesale Market Objectives

In accordance with Clause 2.4.2 of the Market Rules, in deciding whether or not to make Amending 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 Objective (c):

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

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

(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

By replacing the term *under construction* with *committed*, the proposal will allow committed projects with lead times of under two years (for which construction has not begun at the time of application) for example small diesel generators, to be assigned Capacity Credits under step 2A in Appendix 3 of the Market Rules.

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 amendments will improve the clarity of the Market Rules, and remove doubt about these provisions for Facilities which would progress with a high degree of confidence, but may not need to satisfy the under construction criteria. Additional benefits include an improved Reserve Capacity process, and bringing the definition in line with what is used in the National Electricity Market. This will benefit both new participants and investors active in both markets.

The proposed changes to the Amending Rules do not require any change to the Wholesale Electricity Market Systems operated by the IMO or any of the systems operated by System Management.

There have been no additional costs identified with the implementation of this Rule Change Proposal. However, to supplement this Rule Change Proposal, the IMO is amending the Market Procedure for “Declaration of Bilateral Trades and the Reserve Capacity Auction” to include the assessment criteria to enable the IMO to determine whether a Facility is *committed*.

5.3 Views expressed in submissions

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 Amending Rules proposed by the IMO had the support of all parties who made submissions during the first submission period.

Both Alinta and Perth Energy suggested an additional change to clause 4.2.7(b) ii of the Amending Rules for consistency. This was to replace “yet to commence being constructed” with “not committed” (Alinta) or “not yet committed” (Perth Energy). The IMO agrees with the suggestion to further amend clause 4.2.7(b). The additional changes to the Amending Rules are outlined in section 5.5 of this paper.

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 was advised of the proposed pre rule change at its meeting on 11 March 2009. At the meeting the MAC provided unanimous support for the proposal to be formally submitted.

5.5 Additional Amendments

As a result of submissions received during the first submission period the IMO has decided to make a further change to the Amending Rules. The changes to clause 4.2.7(b) and Appendix 3 are as follows (added text, ~~deleted text~~):

- 4.2.7. By the date and time specified in clause 4.1.6, the IMO must publish the following information:
- (a) the number of Expression of Interests received;
 - (b) based on the Expression of Interests, the additional Reserve Capacity potentially available, categorised as:

- i. capacity associated with Facilities that are committed; and
- ii. capacity associated with Facilities that are not yet committed ~~yet to commence being constructed~~, where this capacity is to be further categorised between new Facilities for which:
 1. an offer by the relevant Network Operator to enter into an Arrangement for Access (“**Access Offer**”) has been made and all necessary Environmental Approvals granted;
 2. applications for both Access Offers and Environmental Approvals have been made and one or both are being processed;
 3. no Access Offer has been applied for or some or all Environmental Approvals have not been applied for;

...

Appendix 3: Reserve Capacity Auction & Trade Methodology

Step 3: ...

...

Where two or more offers are tied with respect to the selection criteria such that accepting all but one of them would result in the total capacity selected exceeding the total capacity requirement of the Availability Class then the tied offers are to be accepted according to the following rules until the tie is resolved.

- In the case of the reserve capacity auction, offers from operating facilities and committed facilities are to be accepted ahead of facilities that are not_yet committed; then
- Offers are to be accepted in decreasing order of capacity offered; then
- Offers for capacity that was included in an Expression of Interest are to be accepted ahead of capacity that was not; then
- Offers are to be accepted in the order of the time the offers were received, with the earlier offer being taken first; and then
- Offers are to be accepted in the order the capacity secured Certified Reserve Capacity;

6. THE IMO'S DRAFT DECISION

The IMO's draft decision is to accept the proposed amendments to clauses 4.2.7, 4.14.6 and Appendix 3 of the Market Rules as proposed in the Rule Change Proposal and amended in section 5.5.

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 (c);
- Are consistent with the remaining Wholesale Market Objectives;
- Have no identified costs associated with their implementation; and
- Have the support of both the MAC and all participants providing submissions during the first submission period.

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

7. PROPOSED AMENDING RULES

The IMO proposes to implement the following amendments to the Market Rules as originally submitted by System Management (added text, ~~deleted text~~):

- 4.2.7. By the date and time specified in clause 4.1.6, the IMO must publish the following information:
- (a) the number of Expression of Interests received;
 - (b) based on the Expression of Interests, the additional Reserve Capacity potentially available, categorised as:
 - i. capacity associated with Facilities that are under construction committed; and
 - ii. capacity associated with Facilities that are not yet committed yet to commence being constructed, where this capacity is to be further categorised between new Facilities for which:
 - 1. an offer by the relevant Network Operator to enter into an Arrangement for Access ("**Access Offer**") has been made and all necessary Environmental Approvals granted;
 - 2. applications for both Access Offers and Environmental Approvals have been made and one or both are being processed;
 - 3. no Access Offer has been applied for or some or all Environmental Approvals have not been applied for;
- ...
- 4.14.6. If two or more Facilities cannot simultaneously exist (for example, because more than one Market Participant is proposing to build a Facility that will be

located at the same site,) then the IMO cannot accept a non-zero value provided in accordance with clause 4.14.1(c) in respect of more than one of these Facilities and must reject all but one Facility based on the following criteria:

- (a) Facilities that are operational or are ~~under construction~~ committed will be accepted ahead of other Facilities; then
- (b) if more than one Facility remains, then Facilities that can demonstrate having secured financing will be accepted ahead of other Facilities; then
- (c) if more than one Facility remains, then Facilities with the greatest quantity of Certified Reserve Capacity will be accepted ahead of Facilities with lower Certified Reserve Capacity; then

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The algorithm is as follows:

Step 1: Start with $a = 1$

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Step 2A: In the case of bilateral trade offers, accept offers from operating facilities and committed facilities ~~under construction~~ and remove them from the set of active offers.

Step 3: Accept offers from the set of active offers in order of

- In the case of testing bilateral schedules, decreasing availability.
- In the case of the reserve capacity auction, increasing price

until the capacity requirements of Availability Class “a” are fully covered or until there are no offers left unaccepted in the set of active offers.

Where two or more offers are tied with respect to the selection criteria such that accepting all but one of them would result in the total capacity selected exceeding the total capacity requirement of the Availability Class then the tied offers are to be accepted according to the following rules until the tie is resolved.

- In the case of the reserve capacity auction, offers from operating facilities and committed facilities ~~under construction~~ are to be accepted ahead of facilities that are not yet committed yet to commence construction; then
- Offers are to be accepted in decreasing order of capacity offered; then

- Offers for capacity that was included in an Expression of Interest are to be accepted ahead of capacity that was not; then
- Offers are to be accepted in the order of the time the offers were received, with the earlier offer being taken first; and then
- Offers are to be accepted in the order the capacity secured Certified Reserve Capacity;

...

Step 11: End.

In the case of the auction only:

- While leaving the Reserve Capacity Price unchanged, the IMO must exchange one or more offers not accepted for one or more offers accepted in the auction if
 - the total capacity scheduled in the auction exceeds the Reserve Capacity Auction Requirement by more than 100 MW;
 - the Reserve Capacity Price exceeds zero,
 - the exchange produces the maximum possible reduction in the total value of offers accepted;
 - the exchange does not create an overall Reserve Capacity shortfall where none existed;
 - in the event that a capacity shortfall exists in one or more Availability Classes, the exchange will not shift a shortfall from an Availability Class with low availability to an Availability Class with high availability; and
 - this would not result in an existing facility, or a committed facility ~~under construction~~ being excluded.

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:

- (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

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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.