Independent Market Operator

Wholesale Electricity Market
Rule Change Proposal Submission Form

RC_2009_10 Early Certified Reserve Capacity

Submitted by

Name:	Corey Dykstra
Phone:	9486 3749
Fax:	9221 9128
Email:	corey.dykstra@alinta.net.au
Organisation:	Alinta Sales Pty Ltd
Address:	12-14 The Esplanade PERTH WA 6000
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Submission

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

Background

Under the current Reserve Capacity Cycle, Capacity Credits are assigned to new Facilities around 10 August each year, 24 to 28 months ahead of the date when capacity from the new Facility would be expected to be available to the market.

The IMO claims that a number of Market Participants and potential developers of new Facilities have put the view that the current Reserve Capacity Cycle does not adequately accommodate generation projects that have 'long' lead times. The Rule Change Proposal does not indicate the length of time that is considered to constitute a 'long' lead time.

The IMO also indicates that it has been suggested that financiers are unlikely to finance generation projects based solely on Conditional Certified Reserve Capacity.

The IMO argues that there is merit in providing additional security to project developers who can demonstrate commitment to a project beyond the current Reserve Capacity Cycle timeframes, as this would facilitate new entry and therefore promote competition.

Rule Change Proposal

RC_2009_10 would establish a new concept of Early Certified Reserve Capacity (ECRC), which would essentially assign Capacity Credits to a (committed) Facility outside of the current Reserve Capacity Cycle, and would not require a subsequent application to the IMO for Certified Reserve Capacity as part of a future Reserve Capacity Cycle.

Alinta's views

Alinta does not support RC_2009_10. The Rule Change Proposal lacks demonstrable benefits, would introduce additional complexity into the Market Rules, and may result in less efficient market outcomes.

Firstly, no evidence is provided in the rule change proposal to support a conclusion that there is a need to amend the existing Market Rules as proposed by RC_2009_10. In fact, it is arguable that the observable evidence indicates that the existing Reserve Capacity mechanism and the current Reserve Capacity Cycle have successfully delivered the Reserve Capacity Requirement determined for each Capacity Year to date.

Second, it is implied in RC_2009_10 that the amendments to the Market Rules being contemplated are necessary to provide certainty to developers of generation projects with 'long lead times' and would "…*have a positive effect on the ability…to secure financing*…". However, RC_2009_10 would make the assignment of Capacity Credits through ECRC mechanism contingent on the Facility being deemed to be 'committed' by the IMO.

Although the current Market Rules require Facilities to be 'under construction' to be assigned Capacity Credits, these references are also to be amended to 'committed' if RC_2009_07 is approved. In part, the argument in support of RC_2009_07 was that references to 'under construction' discriminated against Facilities with a short construction period (i.e. less than 24 months) that did not require to physically be constructed at least 24 months ahead of the Facility entering the market.

In RC_2009_07, the IMO proposed that the definition of 'committed' be largely based on the current definition of 'under construction', with some minor changes (which are underlined below).

> *Factors which will be taken into consideration when assessing whether a project is 'Committed' include:*
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> - *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 <u>of planning, construction and environmental applications, approvals and licences;</u>*
> - *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.*

It is clear from the proposed definition of 'committed' provided in RC_2009_07 that a key requirement for satisfying the definition would be financial commitment to the proposed generation project. That is, the generation project must have been subject to, and passed, a Final Investment Decision (FID). It is unlikely that the other elements of the definition would be able to be met without a FID having been made (and hence finance having already been arranged).

RC_2009_10 would make the assignment of Capacity Credits under the proposed ECRC mechanism contingent on the Facility being found to be 'committed'. To the extent that arranging project finance for a proposed generation project is a necessary *precursor* to a FID, it appears that the proposed ECRC mechanism would not provide potential financiers with any greater certainty as to the assignment of Capacity Credits to the new Facility. That is, the introduction of ECRC is unlikely to have a positive effect on the ability of a Market Participant to secure financing for a proposed generation project.

Thirdly, the process to be followed by a Market Participant that has registered a Facility, or which intends to register a Facility, for which it is applying for certification of Reserve Capacity, are set out in Market Rule 4.9, with information requirements set out in Market Rule 4.10. Market Rule 4.11 then sets out the process that must be followed by the IMO in assigning Certified Reserve Capacity.

It is clear that although under the current Market Rules there may be uncertainty about the *level* of Capacity Credits that may ultimately be granted to a Facility, subject to the requirements of the Market Rules being met, there is little risk that Capacity Credits will not be assigned to a 'committed' Facility. Further, uncertainty as to the *level* of Capacity Credits that might be assigned to a Facility by the IMO may be eliminated by applying for Conditional Certified Reserve Capacity.

Conditional Certified Reserve Capacity may be sought at any time to provide certainty with respect to the level of capacity credits that would be assigned to a proposed Facility. While a Market Participant must still lodge an application for Certified Reserve Capacity as part of the normal Reserve Capacity Cycle, the level of Capacity Credits will be the same as the amount of Conditional Certified Reserve Capacity if the information included in the application for the future Reserve Capacity Cycle remains the same as that originally provided.

Finally, to the extent that RC_2009_10 does facilitate the entry of *new* generation capacity as claimed by the IMO, there is potential for this new ECRC capacity to 'crowd out':

- *new* capacity from generation projects with relatively shorter lead times (because RC_2009_10 is likely to favour projects with longer lead time; and

- potential *additional* capacity from other sources that might otherwise be offered through the existing Reserve Capacity Mechanism (including additional capacity that might be available from upgrades of existing generation facilities or to Demand Side Management Programmes).[1]

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

Market Rule 2.4.2 states that the IMO must not make Amending Rules unless it is satisfied that the Market Rules, as proposed to be amended or replaced, are consistent with the Wholesale Market Objectives. The Wholesale Market Objectives are as follows.

(a) To promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system.

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

(c) To avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions.

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

(e) To encourage the taking of measures to manage the amount of electricity used and when it is used.

Alinta considers that the IMO cannot be satisfied that the Market Rules, as proposed to be amended or replaced by RC_2009_10, are consistent with all the above Wholesale Market Objectives.

- RC_2009_10 is unlikely to be consistent with Market Objective (c). If the proposed ECRC mechanism favours projects with longer lead time, this is likely to result in discrimination again particular energy options and technologies as coal fuelled generation tends to have longer project lead times compared with gas fuelled generation.
- RC_2009_10 is unlikely to be consistent with Market Objectives (a) and (d). To the extent that the proposed ECRC mechanism does facilitate the entry of *new* generation capacity as claimed by the IMO, the 'crowding out' of potential additional capacity from upgrades of existing generation facilities or to Demand Side Management Programmes may result in inefficient and higher cost capacity entering the market.

[1] The early entry of new capacity through the proposed ECRC mechanism would place downward pressure on capacity prices, and may discourage new capacity being offered through the existing Reserve Capacity Mechanism as part of a future Reserve Capacity Cycle.

While RC_2009_10 may not be inconsistent with Market Objectives (b) and (e):

- it is unlikely to facilitate efficient entry of new competitors [Market Objective (b)] given arranging project finance is a necessary *precursor* to a FID and the proposed ECRC mechanism would not provide any greater certainty as to the assignment of Capacity Credits to the new Facility; and
- it is unlikely to affect the taking of measures to manage the amount of electricity used and when it is used.

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

The changes to the Market Rules contemplated by RC_2009_10 would not require Alinta to change its IT or business systems, and hence there are no IT or business costs associated with the rule change proposal.

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

The changes to the Market Rules contemplated by RC_2009_10 would not require Alinta to change its IT or business systems, and hence there is no specific period of time that would be required to implement the changes arising from the rule change proposal.