ERM
Power for generations

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WEM Rule Change Proposal: Energy Price Limits Methodology and Consultation Process (RC_2009_35)

Dear Troy,

Thank you for the opportunity to provide comment during the second submission period on Rule Change Proposal RC_2009_35. This letter sets out ERM Power's view of the proposed rule change and the Draft Rule Change Report dated 8 March 2010.

ERM notes that the IMO has changed the drafting of the rule change to remove the specific reference to the approach to be adopted in calculating the Risk Margin. ERM was disappointed that the IMO originally supported the concept of continuing a market failure whereby a generator can be compelled to operate at a loss. In the context of the WEM design, including the existing obligation to bid/offer at Marginal Cost, there is simply no need to constrain the price to the point where a peaking generator can lose money 10% to 20% of the time.

The likelihood of peaking units losing money in the STEM is somewhat higher considering that the mechanism of the STEM does not allow Market Generators to specify Minimum Generation, Ramp Rates and Start Costs. This creates the potential for events of lengthy dispatch at below minimum generation and multiple starts for short duration runs. The commercial consequence of these events is punitive capacity credit refunds (penalties) for the entire Reserve Capacity Obligation Quantity (RCOQ) plus Downward Deviation Penalties and unrecoverable start costs. As an example, a Participant consisting of an aggregation of 2x165MW with an RCOQ of 330MW, in summer faces a $12,427/interval capacity refund cost in the event of being cleared for energy in the STEM below minimum generation. This is a $1,242/MWh consequence in the event that a sale of 10MWh occurs. The Downward Deviation Penalty adds further unnecessary cost to the event.

Currently this high risk is driving Market Generator behaviour of offering capacity at the Maximum STEM Price to avoid uneconomic dispatch. The balancing mechanism of dispatch via system management at least makes provision for Minimum Generation and Ramp Rates and is currently the market that peaking units can make energy available at efficient pricing. The only other alternative for avoiding impractical dispatch is for the peaking unit to pick the times to run by becoming a price taker. This inevitably results in a loss.

ERM supports the removal of the specific reference to the approach adopted in calculating the Risk Margin, however, is concerned that that the IMO will merely adopt this approach when carrying out the annual review. The practical limitations of the current STEM and the punitive capacity and energy penalties should be included in the calculation of the Risk Margin.

Regarding the risk of gas pricing, during the Varanus Island incident large volumes of gas was traded at $20/GJ, and the marginal cost of operating a 40MW gas fired peaking plant would have exceeded the Maximum STEM Price by a considerable margin. Particularly when considering the Maximum STEM pricing was based on a price of $8/GJ. It is not hard to envisage a circumstance where a similar event occurred in summer and gas fired peaking plant would have been compelled to generate for extended periods at an unsustainable loss.

On the basis that the amended rule change proposal has changed the Profit Margin to a Risk Margin (approach unspecified) and has added the requirement for the draft report to include detail on how the IMO has determined the appropriate values, the amended rule change proposal appears to be reasonable. ERM Power, however, maintains that any further modifications of the Market Rules associated with the functioning of the STEM should be done so only in the light of a clear understanding of the practical limitations of the current STEM design.

Yours sincerely,

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