

## Independent Market Operator

MRCPWG

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### Agenda

<b>Meeting No.</b>	2
<b>Location:</b>	IMO Board Room, Level 3, Governor Stirling Tower, 197 St Georges Terrace, Perth
<b>Date:</b>	Tuesday 22 June 2010
<b>Time:</b>	Commencing at 1.00 to 3.00pm

Item	Subject	Responsible	Time
1.	<b>WELCOME AND APOLOGIES / ATTENDANCE</b>	<b>Chair</b>	5 min
2.	<b>MINUTES OF PREVIOUS MEETING</b>	<b>Chair</b>	5 min
3.	<b>ACTIONS ARISING</b>	<b>Chair</b>	5 min
4.	<b>FINALISATION OF MRCP SCOPING QUESTIONS</b>	<b>IMO</b>	20 min
5.	<b>REVIEW OF MRCP COMPONENTS</b>	<b>IMO</b>	60 min
6.	<b>GENERAL BUSINESS</b>	<b>IMO</b>	5 min
7.	<b>NEXT MEETING</b> Friday 2 July 2010 (1:00-3:00pm)	<b>Chair</b>	5 min

## Independent Market Operator

### MRCPWG

<b>Location:</b>	IMO Board Room Level 3, Governor Stirling Building, 197 St Georges Terrace, Perth
<b>Date:</b>	Monday 31 May 2010
<b>Time:</b>	Commencing at 2:00 to 4:15pm

<b>Attendees</b>
Troy Forward

Item	Subject	Action
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The Chair noted that an apology had been received from Chris Brown of the ERA. The following other attendees were noted:

- Rob Pullella (Observer); and
- Ben Williams (Observer)

The Chair noted that the Working Group had a large job ahead of it and provided a brief background to the required review of the Market Procedure and use of MRCP in setting the Reserve Capacity price cap.

The Chair noted that the Working Group would not be reviewing the whole RCM as this is outside its Terms of Reference.

Mr Corey Dykstra noted that it is arguable that the Reserve Capacity Mechanism (RCM) is achieving its intended outcomes, in particular stating that the Reserve Capacity Auction is designed to be a last resort mechanism for security capacity. In response, Mr Rob Pullella and the Chair both noted the objective of the MRCP is to encourage investment in peaking generation in

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Mr Steve Gould questioned whether the Working Group needs to state the objectives or develop them? In response Mr Ben Williams noted that the intent is for the Working Group to develop these, taking into account mechanisms to ensure that if there is uncertainty a solution pathway can be developed easily.

Mr Cremin noted that as the MRCP is a regulated price schedule, the Working Group might want to be prescriptive in developing any solutions to ensure volatility is minimised. The Chair agreed that the Working Group would need to discuss the costs and benefits of any identified approaches to determining the MRCP. For example price fixing vs. reflective of market conditions.

Mr Stephen MacLean noted that the objectives should not be placed in a Market Procedure as they would not have a heads of power and therefore have no legal basis.

Mr Dykstra noted that the Market Procedure should be clear and not discretionary. Further, Mr Dykstra noted that the MRCP is an administratively determined price and as such is neither dynamic nor reflective of the market price.

***What is the best way to give a price signal to achieve the MRCP objectives?***

The Chair clarified that this scoping question relates to whether the MRCP should be a fixed price or reflective of market conditions. Further, whether the MRCP is meant to reflect market conditions at the time the capital is delivered or when capital is purchased. Mr MacLean noted that prices should represent a range of competing prices for various generation types. The Chair noted that the Working Group would need to consider the financial and settlement based outcomes of any amendments.

Mr Dykstra noted that the Working Group needs to understand what is permissible under the Market Procedures.

Mr Cremin noted that the RCM attempts to incentivise generation to enter into the South West interconnected system (SWIS) in order to maintain power system security and reliability. The commercial implications of capacity for the various types of generators differ considerably. In particular, Mr Cremin noted that peaking generation investment decisions are driven by the MRCP (with a limited impact on refunds) and vice versa for base load generation.

*Action Item: Mr Cremin to provide copy of his assessment of the impacts of MRCP on the various types of investors in the market to the IMO by Friday 18 June 2010.*

**Mr Cremin**

***Are the MRCP assumptions still correct and appropriate?***

The Chair noted that the issues around the inclusion of transmission costing in the MRCP calculation will require further consideration by the Working Group.

Mr MacLean noted that there is an inherent inefficiency in the market regarding the MRCP comparative to costs for existing

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plant and suggested that an alternative might be to use multiple prices (for both new and existing plants). Mr Gould noted that a feedback mechanism between over capacity and new capacity is also required to send the right signals to investors. In response, Mr Dykstra noted that these issues relate to the Market Rules and not the Market Procedure. The Chair noted there may be scope to explore these other features and report back to the MAC as recommended amendments to the Market Rules, if deemed appropriate.

*Action Point – The IMO to provide all Working Group members with a copy of the comprehensive issues register.*

The Working Group members discussed and noted the following wider issues around the determination of the MRCP:

- Mr MacLean suggested that forcing an auction to occur each year to get a market based price should be considered. Mr MacLean noted that this may not however lead to an efficient or competitive outcome. In particular, Mr MacLean noted that if an auction is forced and there was sufficient capacity in the market the clearing price may be zero. This would constitute a risk to existing Market Generators which would need to be mitigated. Mr MacLean noted that this would not be a problem for new generators who enter into a Special Price Arrangement.

The Chair noted that the current administrative mechanism caps the cost of contracted capacity but not the price. The excess capacity adjustment limits the total pool of money in the market which is uncontracted but does not limit the volume. Mr MacLean noted that this self correcting mechanism would therefore not result in further cost exposure. Further, Mr MacLean noted that whether the plant

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	<ul style="list-style-type: none"> <li>• Mr Cremin noted that a building block approach is reasonable for determining marginal cost of generation. Further, Mr Cremin noted that investors reliant on a smoothed MRCP going forward, as opposed to bilateral, would be provided more certainty. The Chair noted that a smoothed MRCP would potentially increase the amount of capacity in the market. Mr MacLean noted that the prices in a particular year that an investor determines to construct a plant in the SWIS may vary from the prices that occur in the year that the plant enters the market. This may have a big impact under scenarios where there is high economic growth (either positive or negative).</li> </ul> <p>Mr Cremin also noted that the MRCP has gone up a lot since market start due to the inclusion of different variables into the methodology. The Chair clarified that these had been included as a result of exogenous changes to market conditions such as the resources boom, as well as endogenous structural issues.</p> <ul style="list-style-type: none"> <li>• Mr Rob Pullella stated that the process for including transmission costs into the MRCP should be considered by the Working Group along with the consistency over the use of the rate of return.</li> <li>• Mr Gould noted that the inclusion of transmission costs was a major concern as not only did it cause the recent increase in the MRCP but the increase did not incorporate the approved tariff increases. Mr Gould also recommended that the Working Group consider the impact of the MRCP on behaviour and the achievement of the Wholesale Market Objectives. Mr Gould also noted that as there has been a significant rise in the amount of Demand Side Management on the SWIS the regime needs to be considered from this perspective.</li> </ul> <p>In response, the Chair noted that the IMO had originally proposed to the Office of Energy (OoE) the use of a more robust decay curve. This was however rejected by the OoE. Mr Cremin noted that excess capacity can have a large impact on merchant financed generators.</p> <p>Additionally, the Chair noted that he had received a request from DSM aggregators to have a seat on the Working Group. The Working Group discussed the inclusion of a specific DSM aggregator. The Working Group was of the view that DSM participation would add value to the outcomes of the Working Group and as such agreed to the inclusion of a DSM aggregator representative on the Working Group.</p> <p><i>Action Point: The IMO to undertake an appointment process to include a DSM aggregator representative on the Working Group.</i></p> <ul style="list-style-type: none"> <li>• Mr Nenad Ninkov noted that the Working Group should consider how to determine the best way of financing new investment and what risks should be taken to get plant on</li> </ul>	<p style="text-align: center;"><b>IMO</b></p>

Item	Subject	Action
	<p>system. In response, Mr Cremin noted that investment decisions can vary significantly based on prices.</p> <p>Mr Ninkov also suggested that the definition of a peaking plant (fast start vs. plants which only supply for 1-2% of the year) requires consideration. Mr Alistair Butcher noted that there is currently no criterion for defining a fast start plant. The Chair noted that the first calculation of the MRCP included a dual fuel unit which was removed on the basis that</p>	<p>d</p>

Item	Subject	Action
	<p>Mr Dykstra noted that there is currently an incomplete Market Procedure which requires rectifying to reinstate the Major Components.</p> <p><i>Action Point: The IMO to amend Market Procedure for determining the MRCP to reinstate the 2009 MRCP Major Component values.</i></p>	<b>IMO</b>
<b>4</b>	<p><b>GENERAL BUSINESS</b></p> <p>There were no general business items raised.</p>	
<b>5</b>	<p><b>NEXT MEETING</b></p> <p>The next Working Group meeting will be held Tuesday 22 June 2010 (1:00-3:00pm)</p> <p>The Working Group discussed what an appropriate meeting time would be.</p> <p><i>Action Points: Working Group members to email appropriate meeting times to the IMO for consideration by Friday 18 June 2010.</i></p>	<b>Working Group</b>
<b>6</b>	<p><b>CLOSED</b></p> <p>The Chair declared the meeting closed at 4.15pm.</p>	<b>Chair</b>





Meeting No 2: 22 June 2010

#	Meeting Arising	Responsibility	Action	Status/Progress
6	Meeting 1	Members	Working Group members to email appropriate meeting times to the IMO for consideration by Friday 18 June 2010.	Underway.



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## **Agenda Item 4: Finalisation of MRCP Scoping Questions**

### **1. MRCPWG – ISSUES REGISTER**

The following issues register was developed by Future Effect to provide a starting point for,





1. Given that network costs will vary significantly from site to site, what approach should be taken to best reflect these costs within the MRCP determination?

Note: Matters to be considered include deep and shallow connection costs, use of system charges; the current approach of reviewing a range of scenarios and selecting one (not necessarily the highest cost).

### **1.5 Weighted Average Cost of Capital**

1. Is the calculation of beta currently performed on the basis that reflects current industry best standards and is it appropriate and applicable for its application in the MRCP?

Note: Matters to be considered in this assessment to include: the selection processes for the beta comparator companies; the merits of incorporating an allowance for the actual payment or Capacity Refunds or a premium for to represent the asymmetrical impact they have on revenue streams.

2. Is the calculation of gamma currently performed on the basis that reflects current industry best standards and is it appropriate and applicable for its application in the MRCP?

Note: One matter for consideration is the pay-out ratio for imputation credits.

3. Should a comparative assessment of WACC be undertaken as part of the reporting process, against other similar markets and industries, providing a benchmark (sensitivity test) by which Market Participants can compare the outcomes of the MRCP WACC determination?
4. Are the costs of raising debt and equity adequately reflected in the WACC? Is there a potential double counting between the derivation of WACC and the determination of Margin M?
5. Given the current roles of the IMO and the ERA within the industry framework, is it appropriate for the WACC to be determined by the ERA in the future?

### **1.6 Procedural and timing related issues**

1. Should the Market Rules or the Market Procedures specifically set out which components of the WACC that the IMO would be allowed to update and when?
2. Should there be specific objectives drafted for the MRCP procedure to provide overall guidance in interpreting the procedures? If so, to what extent should the MRCP objectives relate to the Objectives of the Market?
3. Are there current concerns with regard to the timeliness of the MRCP processes? If so, what improvements could be made to make the processes more administratively efficient?





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## **Agenda Item 4 Appendix 1: Maximum Reserve Capacity Price Scoping Questions**

### **1 MRCP HIGH LEVEL**

- Is there a need to define the MRCP Objectives in the Market Procedure?
- What is the best way to give a price signal to achieve the MRCP objectives?
  - Fixed price providing price certainty versus volatile/cost reflective price to ensure accuracy?
  - Are the current adjustment mechanisms appropriate?

### **2 MRCP DETERMINATION**

- Are the MRCP assumptions still correct and appropriate?
  - Auction versus Bilateral trade.
  - Type, design and components.
- What is the appropriate level of IMO discretion?
- Is one submission period sufficient?



## Agenda Item 5: Review of MRCP Components

At the first Maximum Reserve Capacity Price (MRCP) Working Group (MRCPWG) meeting on 11 May 2010 of the Working Group Reserve Capacity Price DC Bn041094 its June 2010 meeting, as outlined

The Working Group is to consider the following options for the MRCP components:

Component	Options	Market Procedure Reference
Power station – type	<ul style="list-style-type: none"> <li>OCGT, low NOx burners</li> <li>Other</li> </ul>	Sections 1.5 to 1.7
Power station – capacity	<ul style="list-style-type: none"> <li>160 MW</li> <li>40 MW</li> <li>Another value linked to forecast demand growth</li> </ul>	Section 1.5
Power station – fuel type	<ul style="list-style-type: none"> <li>Distillate only</li> <li>Dual fuel</li> </ul>	Section 1.5
Power station – capacity	<ul style="list-style-type: none"> <li>2%</li> <li>Other value</li> </ul>	Section 1.5
Handling facilities storage and	<ul style="list-style-type: none"> <li>Current specifications</li> <li>Alternative specifications</li> </ul>	Section 1.9
Transmission connection –	<ul style="list-style-type: none"> <li>Western Power</li> <li>Alternative provider</li> </ul>	Section 1.8
Transmission connection –	<ul style="list-style-type: none"> <li>Linked to land valuation locations</li> <li>Alternative location(s)</li> <li>Optimisation of land &amp; connection costs</li> </ul>	Section 1.8
Transmission connection –		



