

**Independent Market Operator**  
**Reserve Capacity Mechanism Working Group**

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**Minutes**

<b>Meeting No.</b>	1
<b>Location:</b>	IMO Boardroom Level 3, 197 St Georges Terrace, Perth
<b>Date:</b>	Wednesday 15 February 2012
<b>Time:</b>	Commencing at 1.00pm – 5.00pm

<b>Attendees</b>	
Allan Dawson	Chair
Suzanne Frame	IMO

Item	Subject	Action
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	enthusiasm in the taskforce or the industry for a gross energy only market. High priority was placed on reliability and encouraging new plant investment. There was also a concern that price signals from an energy only market to incentivize the level of investment and reliability would have to be quite high. The small number of periods that would be	

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	<p>may prove to not be implementable in practice.</p> <p>The Chair noted that the community seemed more accepting of load curtailment due to specific events such as hailstorms or bushfires, but not due to capacity shortfall on hot summer days. Mr Peake noted that it was even less palatable if shortfalls occur during the shoulder periods.</p> <p>Mr MacLean questioned the criteria used to plan for a 1-in-10 year peak demand event and ensuring reliability of supply. The Chair responded that the cost associated with not having enough capacity was significantly more than the cost associated with an extra unit of capacity. Mr Peake cited the Chamber of Commerce and Industry's work on significant economic losses that result due to power outages.</p> <p>Mr MacLean suggested that the group should consider reviewing the planning criteria for determining the Reserve Capacity Requirements as the IMO was not forming a separate group for that purpose. The Chair noted that the IMO would share the Scope of Work for that review with the RCMWG.</p> <p>Mr Peake and the Chair noted that the RCM is not just about costs, it also involved meeting market stakeholder expectations that have been built up over the years.</p> <p>There was a discussion around the competing nature of the Wholesale Electricity (WEM) Market Objectives. Mr Cremin noted that stakeholder expectations change over time. He cited the black outs in 2004 and shortages experienced in 2008 to note that the price must be dynamic and sensitive to stakeholder expectations. Mr Peake suggested that it might be useful to have a flexible Reserve Capacity Target.</p> <p>Mr MacLean noted that the discussions indicate the need to consider issues such as multiple prices for different types of capacity. Mr Cremin noted that the group should not get too focussed on differential capacity prices because they already exist to some degree as a result of the contractual nature of markets. Mr MacLean reiterated that Mr Thomas had also suggested that a dynamic capacity price should be considered in conjunction with a dynamic refund regime.</p>	
3.	<p><b>DEFINITION OF CAPACITY</b></p> <p>The Chair invited comments on the working definition of capacity provided in the IMO's paper.</p> <p>Mr Dykstra noted that the paper was useful but added that he was interested in assessing the characteristics of capacity in terms of what it provides to the market. The Chair proposed that the issue of differential characteristics of capacity should be dealt with after adequate consideration had been devoted to understanding what capacity actually is. He suggested that it was important as a first step to recognize the need to deal with capacity as a homogeneous product before its characteristics are discussed. Mr MacLean suggested that it would be important to consider both issues together because there was a danger of losing some level of economic efficiency if differential capacity prices were not considered. The Chair noted that there was also a risk of losing technological innovation by overly refining the price of capacity. Mr MacLean added that different approaches to defining capacity and its characteristics should be considered and that he would</p>	

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	<p>put forth some examples for the group to consider as work progressed.</p> <p>Mr Cremin highlighted that homogeneity in the capacity market did not exist presently as the market dealt with capacity resources from differing sources differently. The challenge was to decide if the Market Rules should apply discount factors depending on the technological features of different capacity resources or should the market be allowed to set the price.</p> <p>Mr Andrew Stevens proposed a definition of capacity that differentiates generation and DSM resources. He suggested that DSM effectively reduced the level of peak demand which should ideally translate into cost savings as a reduced level of generation capacity would then be required to serve the potential reduced demand level. The Chair queried as to how the market would incentivize the DSM owners to reduce their demand to which Mr Stevens replied that differential capacity and energy payments should be made. Mr Jeff Renaud argued that Mr Stevens' point actually implied a higher price for DSM.</p> <p>Mr MacLean added that efficiency gains could be made by pricing DSM lower as it is used less frequently and has a lower fixed cost than generation capacity. Mr Dykstra clarified that the level of peak demand would technically remain the same regardless of whether DSM is dispatched as the system demands would not have changed.</p> <p>At this point there was a discussion on the availability of DSM for limited periods during the year. The Chair responded that going forward DSM would likely be dispatched more frequently if there were no operational impediments in doing so.</p> <p>The group discussed the value provided to the market by DSM. Mr MacLean observed that DSM provided a lower cost product to the market. Mr Tan highlighted that the market must price the product according to the value it delivers.</p> <p>At this point the Chair noted that while there was some merit to the point about limited availability of DSM, it was offset to some extent by the high level of reliability it provided.</p> <p>Mr Sutherland highlighted the difference between generators and DSM with regard to the penalties for non-performance. In support of his argument, he compared the magnitude of lost revenue for DSM with capacity refunds for generators in the event of non-performance. Mr Renaud highlighted that costs were irrelevant and attention must be paid to the value provided to the market by DSM.</p> <p>The Chair stressed that it was important to understand the difference between cost and value. Mr Cremin observed that the value propositions of different capacity resources were different. He gave an example of capacity offered by a baseload generator at all times versus capacity offered by DSM at peak times. Mr Sutherland believed that given different availability factors, it seemed that differential pricing would be the best way forward. The Chair considered that capacity resources should be remunerated at the same level because the product they provide is equivalent. Mr Cremin used the example of a gross energy pool market to make the point that in a market situation,</p>	

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	<p>because the price would be applied differently. Mr MacLean agreed that such a price signal did not exist in the RCM. He further added that alternative approaches such as those offered by the New York- ISO capacity market should be evaluated with a degree of simplification.</p> <p>Mr Cremin concluded even if capacity was considered a homogeneous product, it was important to recognize that there is a misallocation of revenues to different technologies because of the absence of a market mechanism. Mr MacLean offered to present to the group different approaches to the treatment of this matter.</p> <p>Mr Stevens re-raised his point that peak demand should exclude the sum of the reductions that demand side options are willing to offer in the market at any time. The Chair brought the members' attention to the value of lost load and the significant cost of load-shedding to the economy. Mr Greg Ruthven also explained using an example that</p>	

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	<p>The Chair agreed that the Reserve Capacity Price was a key issue particularly in last couple of years, driven by the calculation of the transmission connection cost in the MRCP. The Chair opined that the situation could have been quite different if say, large loads indeed connected before the Global Financial Crisis or DSM had not developed in the market. Mr Renaud argued that there is a finite opportunity for DSM to enter into a market. DSM providers in the market have not reacted to price signals but rather market opportunities. He suggested that in most international markets, DSM is generally at about 8-9% of total capacity.</p> <p>Mr MacLean noted that excess capacity was a problem because the price was not competitively set. He suggested that the discount factor that should create a price signal was too sluggish to limit over supply. There was a discussion among members on bilateral contracting and sensitivity of the MRCP.</p> <p>The Chair pointed out that Mr Thomas's suggestion that the MRCP is too high may be demonstrated by the fact that no one had incurred transmission costs that were included in previous MRCP</p>	

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	<p>He confirmed that this work would however, not affect the MRCP determination for this year.</p> <p>Mr MacLean queried if the scope of work for the forecasting methodology would be shared with this group. The Chair confirmed that it would.</p> <p><i>Action: The IMO to invite Mr Mike Thomas to the next meeting to present a paper on the oversupply of capacity and to include the requests of the members on a) a direct control mechanism by the IMO on the amount of capacity entering the market and b) updating data on bilateral contracting of capacity</i></p> <p><i>Action: The IMO to share scopes of work for the five-yearly review of the Planning Criterion and the IMO's forecasting processes</i></p>	
5	<p><b>PROPOSED RCMWG MEETING DATES 2012</b></p> <p>The IMO tabled proposed alternative RCMWG meeting dates to those distributed previously in the meeting papers, to ensure there was no overlap with the Gas Advisory Board's scheduled meetings. Working Group members were generally comfortable with the revised dates.</p> <p>Mr MacLean requested if meeting start times could be changed to 2.30pm. The Chair confirmed that the IMO will try to accommodate Mr MacLean's request.</p>	
6	<p><b>GENERAL BUSINESS</b></p> <p>No general business was discussed</p>	
7	<p><b>CLOSED</b></p> <p>The Chair thanked all members for attending and declared the meeting closed at 3.45pm.</p>	