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## Wholesale Electricity Market – Procedure Change Proposal

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Procedure Change No: PC\_2009\_12

### Change requested by

<b>Name:</b>	Allan Dawson
<b>Phone:</b>	08-92544300
<b>Fax:</b>	08-92544399
<b>Email:</b>	<a href="mailto:imo@imowa.com.au">imo@imowa.com.au</a>
<b>Organisation:</b>	IMO
<b>Address:</b>	Level 3, 197 St Georges Terrace, Perth, WA 6000
<b>Date submitted:</b>	20 November 2009
<b>Procedure change title:</b>	Amendments to the Market Procedure for Determination of Maximum Reserve Capacity Price
<b>Market Procedure(s) affected:</b>	Market Procedure for Determination of Maximum Reserve Capacity Price

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### Introduction

The IMO or System Management, as applicable, may initiate the Procedure Change Process by developing a Procedure Change Proposal. Rule Participants may notify the IMO or System Management, as applicable, where they consider an amendment or replacement of a Market Procedure would be appropriate.

If an Amending Rule requires the IMO or System Management to develop new Market Procedures or to amend or replace existing Market Procedures, then the IMO or System Management, as applicable, is responsible for the development, amendment, or replacement of Market Procedures so as to comply with the Amending Rule.

Market Procedures:

- (a) must:
  - i. be developed, amended or replaced in accordance with the process in the Market Rules;
  - ii. be consistent with the Wholesale Market Objectives; and
  - iii. be consistent with the Market Rules, the Electricity Industry Act and Regulations; and
- (b) may be amended or replaced in accordance with clause 2.10 and must be amended or replaced in accordance with clause 2.10 where a change is required to maintain consistency with Amending Rules.

The Wholesale 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 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; and
- (e) to encourage the taking of measures to manage the amount of electricity used and when it is used.

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## Details of Procedure Change Requested

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### 1. Provide a reason for the proposed new, amended or replacement Market Procedure:

Each year the IMO is required to conduct a review of the Maximum Reserve Capacity Price (MRCP). As part of this review the IMO determines the weighted average cost of capital to be applied to various costing components of the MRCP.

The methodology adopted by the IMO to determine the Weighted Average Cost of Capital (WACC) is outlined in section 1.13 of the Market Procedure for the Determination of the Maximum Reserve Capacity Price (Market Procedure) and involves a number of components that require review. These components are classed as those which require review annually (called minor components) and those structural components of the WACC which require review less frequently (called major components).

Currently the Market Procedure prescribes the values for the major components to be included in the WACC, for example a market risk premium of 6.00%. The values of the major components were developed before the volatility experienced in financial markets over the past 12 months. As such, the IMO considers that these values are out of date and do not reflect the current economic climate and therefore should be updated. In contrast the procedure allows the values for the minor components to be left to be determined by the IMO as part of the annual review process.

In order to change the major components to be relevant for the year they apply to the IMO considers that it must initiate a Procedure Change Proposal each year that a change is required to reflect economic conditions. This current process poses a procedural issue as the IMO would not be aware that the major components would require change until the IMO receives external financial advice as part of the annual MRCP process. The result of this procedural issue is that any changes to the major components to be used in the calculation of the WACC would require a procedure change in parallel with the consultation for the MRCP draft report.

This Procedure Change Proposal has been initiated to correct this procedural issue and enable the IMO to reflect the advice provided by The Allen Consulting Group in the determination of the 2010 MRCP. In particular, in its report The Allen Consulting Group identified that following the recent financial downturn

there has been a significant change to the major components used to determine the WACC. A copy of the report prepared by The Allen Consulting Group is available on the IMO's webpage.

The IMO proposes to update the Market Procedure so that the major components of the WACC are not prescribed in the Market Procedure. This will allow for revised values for the major components to be included in the determination of the WACC.

The IMO considers that the proposed changes will ensure that the IMO can determine a MRCP that reflects the true cost of bringing capacity into the WEM, while still giving Market Participants the ability to comment on the components used to determine the WACC.

The proposed changes will give greater visibility to the financial implications of changes to the WACC components as the outcomes of the changes on the MRCP can be calculated with the actual values that will be used in the final MRCP figure. In addition, the IMO considers that the proposed changes will allow the IMO to update the major components included in the calculation of the WACC inline with changes in operating conditions in the future.

The proposed amendments to the Market Procedure do not attempt to allow for a methodological change, but rather will allow for revisions to the values the determinant information. The IMO notes that it will conduct a review of the methodology used to calculate the MRCP, as specified in clause 4.16.9, before the start of next years MRCP process.

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## **2. Provide the wording of the amended Procedure**

The proposed amendments to the current Market Procedure for Determination of Maximum Reserve Capacity Price are provided as an attachment to this proposal.