Draft amended MRCP Market Procedure			
Number	**Issue**	**Comments**	**Response**
Corey Dykstra			
1	Changes to methodology	Having been involved in the MRCPWG, I am generally comfortable with the changes to the methodology being recommended for calculating the MRCP.	Noted.
2	Step change in MRCP	However, recent discussions with internal and external stakeholders indicate that notwithstanding the 'correctness' of the proposed methodology, the significant step change in the MRCP that results from adopting the recommended changes to the methodology may be associated with unintended consequences. Not the least of these being a perceived increase in 'regulatory' (and commercial) risk associated with investing the WEM, which could act to affect the perceived attractiveness of future investment in the market.	The IMO considers that the review of the methodology for determination of the MRCP has been clearly signalled in the Market Rules, the last two MRCP determinations and the last two Statements of Opportunities (SOO). That the Market Rules require a review of the methodology to be undertaken every 5 years, by implication allows the methodology to evolve over time. The IMO considers that the MRCP is a technical parameter that is supported by prudent engineering cost estimates. As Mr Dykstra has indicated, the proposed changes seek to more "correctly" reflect the actual costs faced by project developers. The IMO considers that by reflecting the actual costs faced by project developers greater economic efficiency will likely be promoted in the market, particularly with regard to investment decisions. The MRCP is determined without regard for the supply-demand balance and is not, in itself, intended to be an investment signal. The IMO notes that the downstream functions of the MRCP (calculation of the Reserve Capacity Price and Reserve Capacity refunds) are intended to provide signals to Market Participants. These two mechanisms are being separately considered in the Reserve Capacity Mechanism (RCM) review that has been commissioned by the IMO Board. Notwithstanding the potential for a significant change in the MRCP if the proposed changes are implemented, the IMO expects that the proposed methodology (particularly the revision to the calculation of the transmission connection cost estimate) could be expected to reduce price volatility compared with the existing methodology. The IMO also notes the design of the RCM is such that a project developer may address price risk through a bilateral contract with a Market Customer.
3	Terms of Reference of MRCPWG	On reflection, I note that the terms of reference of the MRCPWG included consideration of: • the implications of any changes to the MRCP on improving the delivery of the Market Objectives; and • the financial costs and benefits of implementation. While the Draft Procedure Change Proposal does estimate the impact of the proposed new methodology on the MRCP, it may not necessarily canvass the full range of potential financial costs and benefits that may be associated with the proposal, including for example the extent to which it may or may not affect efficient new generation entry.	The Procedure Change Proposal includes consideration of the implication of the proposed amendments on improving the delivery of the Market Objectives (see Section 4). The Procedure Change Proposal also provides an indication of the impact of the proposed changes if they had been applied in the calculation of the MRCP for the 2013/14 Capacity Year. The IMO notes that this indicative analysis is provided for information only and is reflective of the outcomes of the proposed methodology at a point in time. An overview of the financial costs and benefits has also been added to the Procedure Change Proposal. However, broader economic analysis of the impact of the proposed amendments on future investment, as suggested by Mr Dykstra, falls outside the MRCP review, which is a review of a technical parameter that is supported by prudent engineering cost estimates.
4	Need for further consultation	It would appear prudent to provide industry stakeholders with an opportunity to provide feedback to the IMO on these issues as part of the proposed industry workshop prior to the draft Procedure Change Proposal being formally submitted as a procedure change proposal.	The MRCP review has been clearly signalled (see response 2 above) and the proceedings of the MRCP Working Group (MRCPWG) have been available on the IMO website throughout the review process. In addition, the public workshop and the public consultation period within the Procedure Change Process provide opportunity for industry stakeholders to provide feedback on the proposed amendments. Nevertheless, the IMO notes that the Procedure Change Proposal can be submitted after the public workshop without operational impact and has agreed to do so.
Stephen MacLean			
5	Purpose of MRCP	The MRCP was designed as a maximum clearing price applicable if a Reserve Capacity Auction is undertaken by the IMO in Year 1 of a Reserve Capacity Cycle. The relevance of the MRCP is to set a price sufficient to allow a peaking generator to be underwritten by the market in circumstances where the market does not bilaterally trade sufficient volume to meet the SOO expected forecast.	The IMO notes that the MRCP is determined based on the cost to develop a peaking generation project.

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6	Bilateral trading of capacity	The expectation is that capacity will largely be bilaterally traded between capacity providers, potential capacity providers and capacity liable participants. This has been represented in the bilateral trade nomination of each Year 1 of the Reserve Capacity Cycles, but as recent data has shown, has not been reflected in actual bilateral trades. Surprisingly, it has been revealed that over 50% of capacity is not bilaterally traded but instead paid directly by the IMO. It has been suggested that this indicates that the Reserve Capacity Price, which is derived from the MRCP, is set too high and so attracts more capacity than required by the SOO, and also that too high a Reserve Capacity Price leads Market Customers to seriously question the sense in bilaterally trading with that capacity.	Noted.
7	Link between MRCP and Reserve Capacity Price	As a price setting cap in the event of an auction, or as a step-in need by the IMO to underwrite an incremental volume of capacity, the MRCP has relevance. The more important question is its relevance in setting the Reserve Capacity Price when no auction is held. Given the ever-growing volume of surplus capacity, a reasonable person would have to question whether using an 85% MRCP scaled by surplus capacity is, as is currently the case, a reasonable approach to determining the Reserve Capacity Price. One therefore may not have difficulty with the concept of an MRCP for underwriting incremental volume needed to meet the SOO expected forecast, but clearly its default purpose in setting the Reserve Capacity Price in the absence of an auction is reason for concern.	As noted in response 2, the Reserve Capacity Mechanism review is considering the appropriateness of the current equation for calculating the Reserve Capacity Price.
8	Suggestions of transition MRCP	It has been suggested that, given the likely reduction in MRCP for 2014/15 from the all time high of 2013/14, the full discount should be phased in, allowing the higher price to be maintained. This has been presented as a sovereign or market risk to investment and even a possible conflict with an optimal mix of capacity. Quite clearly in our market there are capacity providers and those who are liable to fund that capacity. It appears, from the transition argument that capacity providers wish to maintain a higher capacity price via the application of a higher MRCP. However, those liable for capacity wish to pay only for capacity up to the value they are receiving from that capacity. Any observer of the market can see, as has been made evident by the level of direct capacity payment by the IMO and the amount of excess capacity in the market, that the resulting capacity price is too high. Rational capacity investors can also see that current prices are too high, unsustainable and grossly inefficient and would therefore make their plans on a more reasonable and sensible price. Failure by investors to do this is not a problem for the market but for the investors themselves. If the IMO was considering introducing a MRCP transition price, the question to be answered is: how could it be justify to those paying for capacity that they will be getting value for money. It is also worth noting that the Reserve Capacity Price, as a result of the increase in the MRCP, will go up considerably in the next few years in spite of rapidly increasing excess capacity. When prices are going up no transition is applied, so if one considers symmetry, one must be led to the conclusion that a transition price is not appropriate when the prices are coming down. One should also recognise that the predicted $184,000 MRCP is not high in comparison with past prices whereas the $238,500 MRCP for 2012/13 is noticeably more than has been needed to bring on new capacity resulting in a nearly 9% surplus. It should also be remembered (all too often forgotten) that the market exists to achieve value for money in the form of cost efficient prices to the end users of electricity - all 945,000 customers in the SWIS. It is questionable whether a transitional arrangement, that would maintain high Reserve Capacity Prices via the MRCP setting process, fits with the market objectives.	Noted.

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9	Size of incremental generator	It is understood that the working group reviewed the practicality of setting the MRCP based upon a 160 MW open cycle gas turbine firing liquid fuel or upon another size of generator. The conclusion was that 160 MW was the preferred size, given expected economies of scale, even though suggestions were made that a more practical size of generation facility being underwritten by the MRCP should be 40 MW. Clearly, the smaller sized generator would find more opportunities to connect onto Western Power's network than the larger facility and no clear total cost argument (i.e. generator plus connection) was made that a larger facility was always cheaper. To this end the MRCP procedure should consider more than one facility size, given that due to changes in network costs, the larger unit may not be the cheaper or better choice. The question of what is the relevant size is therefore an unresolved point and will need to be looked at again before the next review period.	It was agreed by the Working Group that the MRCP should continue to be based on the cost to develop a 160 MW liquid-fuelled OCGT. In particular, Western Power advised that it anticipated that connection of a number of smaller facilities would not yield cost savings due to the economies of scale of connecting a single 160 MW facility at a single site.[1] However, the proposed methodology for estimation of transmission connection costs considers access offers and access proposals for a range of facilities of various sizes. The previous methodology only considered the cost of connecting a 160 MW generator at a prescribed list of locations in the SWIS, so did not consider the connection opportunities to which Mr MacLean refers.
10	Western Power connection costs	Synergy has previously commented on the change to Western Power's costs as part of the MRCP calculation. In summary, Synergy supported the SKM proposal, given it represents realistic costs, rather than the current methodology that results in costs no investor or market would seriously consider. Capacity investors and their bilaterally traded underwriters recognise that high transmission costs, including the building of new transmission capacity, are not relevant to peaking generators and could only be justified for base load facilities. For completeness, it is noted that the MRCP process does not concern itself with determining the cost of base load generators.	Noted.
11	Inlet cooling	The application of inlet cooling as a requirement to reduce the MRCP is a sensible addition. The more than proportionate increase in capacity credits for a small increase in costs results in a lower per MW cost.	Noted.
Peter Mattner			
12	Impacts of proposed changes	Western Power's primary concern is that the proposed changes are not supported by any robust economic analysis. 1. The MRCP Terms of Reference included carrying out such an assessment prior to recommendations being put forward to the MAC, and in particular: • Consideration of the implications of any changes to the MRCP on improving the delivery of the Market Objectives; • Detailed feedback as to the implications to the operation of the existing WEM processes and physical outcomes; and • Consideration of the financial costs and benefits of implementation. 2. Analysis has been performed by the IMO to establish the estimated impact of implementation of the agreed changes on the MRCP mechanism itself but not the market as a whole. The MRCP has many uses under the rules, but perhaps most significantly it is a key signal for generation investment. The signals for new generation investment provided by the WEM however, not only include RCM, but also Bilateral Contract prices, STEM and Balancing outcomes, and the role of deep connection charges. These are designed to work together to incentivise the right mix, timing and location of new generation capacity, and therefore should not be considered in isolation. 3. In addition to the net economic benefits, the need to minimise the volatility of pricing signals (in order to provide investor confidence) needs to be recognised. 4. Such a significant step change in MRCP is likely to have a material impact on the financial outcomes for some market participants and Western Power believes that rigorous assessment of the net economic benefits of the proposed changes is an essential precursor to a decision being taken.	See responses 2, 3 and 8 above. As noted above, the MRCP is a technical parameter supported by prudent engineering cost estimates. Additional explanation of the implications to the operation of the existing WEM processes and physical outcomes has been added to the Procedure Change Proposal. In summary, the Reserve Capacity Price and the value of Reserve Capacity Refunds will change proportionally with the MRCP. STEM and Balancing prices, which are based on Short Run Marginal Cost, should not be directly affected by changes to the MRCP.

[1] See Minutes of Meeting 5, available at http://www.imowa.com.au/mrcpwg.

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13	Transmission cost methodology	5. With respect to the new Transmission Cost methodology, from 2006 to 2009 Western Power made estimates of the deep connection costs which were largely based on previous capital contributions received from customers. On occasions these estimates were scaled from year to year by the IMO by the escalation factor provided by their technical consultants. At the request of the IMO, for the 2010 and 2011 MRCP (for the 2012/13 and 2013/14 Capacity Years) Western Power undertook a substantial amount of work to provide detailed forward looking estimates of the deep connection costs at each of the six sites nominated in the procedure. The ERA Decision on MRCP for the 2013/14 Reserve Capacity Year accepts the value of $48.798 million for transmission connection costs as being reasonable. The proposed revised Market Procedure requires Western Power to use actual capital contributions from users to calculate a single estimate of deep connection costs. This follows a recommendation by Sinclair Knight Merz (SKM), given their view that actual capital contributions will provide a better estimate of the actual network connection costs to be incurred by future users. While Western Power is prepared to accept this view, we do not necessarily accept that the argument for it is robust. Indeed past capital contributions have been less than our detailed forecasts but recent connections have been somewhat opportunistic and the capital contributions have been consequently low (relatively speaking). 6. The revised Market Procedure would consequently see a significant reduction in the MRCP due to the amended methodology of estimating deep connection costs. The lower estimates of deep connection costs to be included in the MRCP have not been derived from an expectation of less expensive network augmentations alone, rather a view that the capital contributions paid by a user will be less. The reason for this has not been explicitly identified by SKM, but it could be assumed that it is a result (in part at least) of a simple reinterpretation of the benefits to be included under the New Facilities Investment Test in the Access Code which would consequently require Western Power to fund more of the required network augmentations itself, with Market Participants paying proportionately less. However, this is not the case. Capital contributions for new connections are assessed on an individual basis under the approved Capital Contributions Policy and in no way relate to the transmission component of the MRCP.	The IMO considered that estimates provided by Western Power from 2006 to 2009 lacked detail and transparency. The IMO agrees that it asked Western Power to provide a more transparent and detailed estimate of the actual connection costs that would be faced by a project developer. Following a series of discussions with Western Power, it was acknowledged that detailed estimates would require the nomination of specific locations and decided that these be the same locations that are nominated in the Market Procedure for the land costs. The MRCP Advisory Group had previously recommended in its final report (February 2008) that the cheapest land cost be used so the IMO retained this principle by applying the costs for the location with the cheapest combination of land and transmission costs. The IMO also notes that the 2010 estimate provided by Western Power for the shared connection cost at the cheapest location was more than 350% higher than the indicative value provided for the 2009 MRCP[2]. The IMO notes that the ERA Decision on the MRCP for the 2013/14 Capacity Year states that the value of $48.798 million for transmission connection costs "*reasonably reflects the application of the method and guiding principles described in clause 4.16 of the Market Rules and the MRCP Market Procedure*"[3]. The ERA made no statement in relation to whether this value was reasonable. The IMO also notes that the ERA Decision on the MRCP for the 2012/13 Capacity Year states that "*The Authority considers that the IMO, in conducting the review of the MRCP Market Procedure - described in clause 4.16.9 of the Market Rules - before the publication of the MRCP for the 2011 Reserve Capacity Cycle, should give due consideration to the step in the procedure that requires Western Power to estimate deep connection costs, particularly in respect of ensuring that estimated deep connection costs meet the requirements of the NFIT prescribed in the Access Code.*"[4] In its report for the MRCPWG, SKM indicated that "*The existing methodology represents an opportunity for significant inaccuracy in the order of ±30-50% of the actual completed cost of the connection asset*". In addition, "*The lack of dedicated options analysis has the opportunity to introduce significant inaccuracies*". As the proposed methodology is based on actual connection costs and access proposals, it automatically accounts for the dedicated options analysis. The inclusion of access proposals in the methodology allows it to consider the cost of future augmentation, not only previous connection works.
14	Volatility in MRCP	In summary, Western Power is concerned that the volatility of a 24% reduction in a key market parameter represents a significant price shock for some participants which may have a material financial impact. It appears that no assessment of the overall net economic benefit has been performed and it is not possible to say whether the MRCP is indeed too high or too low to promote the economically efficient, safe and reliable production and supply of electricity. Even if substantial changes to the MRCP are justified, serious consideration must be given to limiting or smoothing the price movements from year to year in order to provide reasonable certainty to existing and potential market participants.	See responses 2, 3 and 8 above.
Steve Gould			
15	Transparency of process	I would suggest that the Procedure Change, net of any industry workshop or otherwise, should be formally published sufficiently before the time at which security deposits and / or capacity certifications are confirmed during the current certification round. I perceive that	The IMO agrees and distributed the Procedure Change Proposal on 19 August to Market Participants that had been assigned Certified Reserve Capacity.

[2] From Final Reports for the 2011/12 MRCP (shared connection cost of $10.158m) and 2012/13 MRCP (shared connection cost of $46.801m), available from http://www.imowa.com.au/mrcp and http://www.imowa.com.au/mrcp_archive

[3] Paragraph 26, *Decision on the Maximum Reserve Capacity Price proposed by the Independent Market Operator for the 2013/14 Reserve Capacity Year*, 28 January 2011, available from http://www.erawa.com.au/cproot/9296/2/20110128%20-%20Decision%20on%20the%20Maximum%20Reserve%20Capacity%20Price%20proposed%20by%20the%20Independent%20Market%20Operator%20for%20the%20201314%20Reserve%20Capacity%20Year.pdf

[4] Paragraph 25, *Decision on the Maximum Reserve Capacity Price proposed by the Independent Market Operator for the 2012/13 Reserve Capacity Year*, 29 January 2010, available from http://www.erawa.com.au/cproot/8314/2/20100129%20Decision%20on%20the%20Maximum%20Reserve%20Capacity%20Price%20proposed%20by%20the%20IMO%20for%20the%202012-13%20Reserve%20Capacity%20Year.pdf

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		this would potentially avoid any irreversible surprises for any new capacity initiatives about to be certified.	