



**Independent Market Operator**

**Final Rule Change Report:  
Early Certified Reserve Capacity**

**Ref: RC\_2009\_10**

**Date: 15 September 2009**



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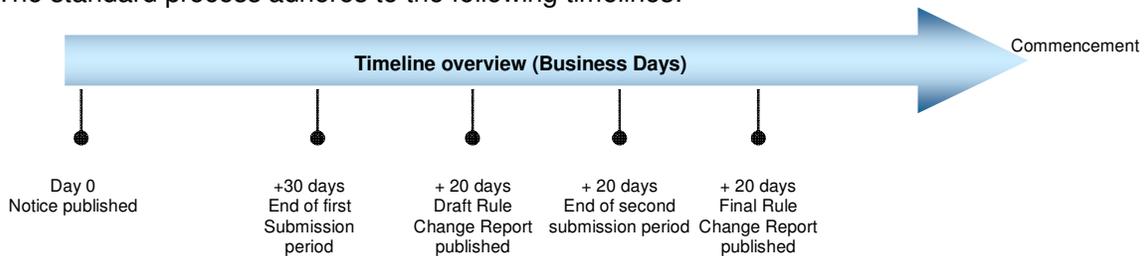
## 1. INTRODUCTION

On 21 April 2009 the Independent Market Operator (IMO) submitted a Rule Change Proposal regarding changes to clauses 4.1.1A, 4.5.2, 4.9.3, 4.11.1, 4.12.6, 4.15.1, 4.15.2, Chapter 11 Glossary and Appendix 3, and the addition of clauses 4.28C, 4.28C.1, 4.28C.2, 4.28C.3, 4.28C.4, 4.28C.5, 4.28C.6, 4.28C.7, 4.28C.8, 4.28C.9, 4.28C.10, 4.28C.11, 4.28C.12, 4.28C.13, 4.28C.14, 4.28C.15 of the Wholesale Electricity Market Rules (Market Rules).

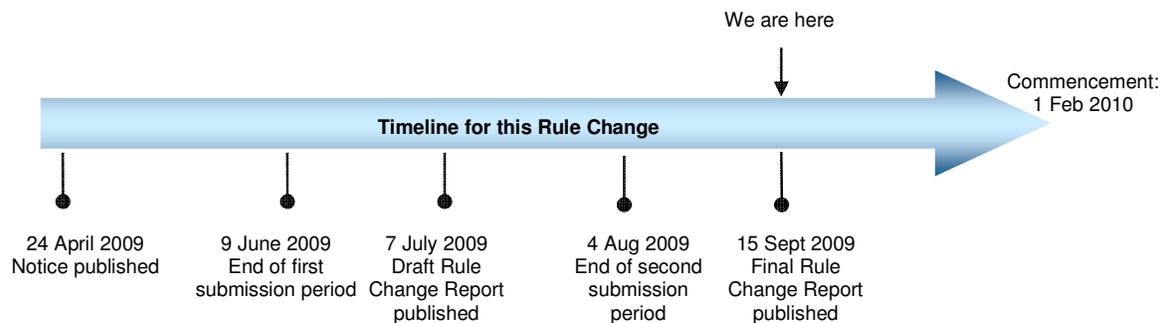
This proposal was processed using the Standard Rule Change Process, described in section 2.7 of the Market Rules.

In accordance with clause 2.5.10 of the Market Rules the IMO decided to extend the timeframe for preparing the Final Rule Change Report until 15 September 2009. A notice of extension was published in accordance with clause 2.5.12 on the IMO website on 17 August 2009.

The standard process adheres to the following timelines:



The key dates in processing this Rule Change Proposal, as amended in the extension notice, are:



The IMO's final decision is to accept the Rule Change Proposal. The detailed reasons for the IMO's decision are set out in section 8 of this report.

In making its final decision on the Rule Change Proposal, the IMO has taken into account:

- the Wholesale Market Objectives;
- the practicality and cost of implementing the proposal;
- the views of the Market Advisory Committee (MAC); and
- the submissions received.

All documents related to this Rule Change Proposal can be found on the IMO website: [http://www.imowa.com.au/RC\\_2009\\_10](http://www.imowa.com.au/RC_2009_10)

## 2. THE RULE CHANGE PROPOSAL

### 2.1 Submission Details

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<b>Date submitted:</b>	21 April 2009
<b>Urgency:</b>	Medium
<b>Change Proposal title:</b>	<b>Early Certified Reserve Capacity</b>
<b>Market Rule(s) affected:</b>	Clauses 4.1.1A, 4.5.2, 4.9.3, 4.11.1, 4.12.6, 4.15.1, 4.15.2, 4.28C (new), 4.28C.1 (new), 4.28C.2 (new), 4.28C.3 (new), 4.28C.4 (new), 4.28C.5 (new), 4.28C.6 (new), 4.28C.7 (new), 4.28C.8 (new), 4.28C.9 (new), 4.28C.10 (new), 4.28C.11 (new), 4.28C.12 (new), 4.28C.13 (new), 4.28C.14 (new), 4.28C.15 (new), Chapter 11 Glossary and Appendix 3

### 2.2 Summary Details of the Proposal

Conditional Certified Reserve Capacity may be obtained in advance but does not guarantee that Capacity Credits will be subsequently assigned to the Facility. Certainty is only available if the Facility is considered by the IMO to be under construction and when bilateral trade declarations are submitted around 10 August each year.

This Rule Change Proposal introduces the new concept of **Early Certified Reserve Capacity** (ECRC) which extends the timeframes for certification of Reserve Capacity and the assignment of Capacity Credits for those new generation Facilities who can demonstrate commitment to a project beyond the current timeframes. This will allow projects with long lead times to secure Capacity Credits earlier and provide greater certainty for investors.

The detailed information on the proposal is contained in Appendix 1 and can also be found in both the Rule Change Proposal and Draft Rule Change Report contained on the IMO's website.

### 2.3 The Proposal and the Wholesale Market Objectives

The IMO submitted that the proposed changes will allow the Market Rules to better address market objective (b):

*"to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors"*

By facilitating the entry of new generation Facilities with long lead times as it will add certainty to the income stream around Capacity Credits. It is expected that this will have a positive effect on the ability for a Market Participant to secure financing for a new generation Facility.

The IMO considered that the proposed changes are consistent with market objectives (a), (c), (d) and (e).

#### **2.4 The Amending Rules Proposed by the IMO**

The Amending Rules originally proposed by the IMO were presented in the Rule Change Notice, available on the IMO website.

#### **2.5 The IMO's Initial Assessment of the Proposal**

The IMO decided to proceed with the proposal on the basis of its preliminary assessment, which indicated that the proposal was consistent with the Wholesale Market Objectives.

The details of the IMO's assessment of the Rule Change Proposal against the market objectives were published in the Rule Change Notice on 24 April 2009.

### **3. FIRST SUBMISSION PERIOD**

The first submission period for this Rule Change Proposal was between 28 April 2009 and 9 April 2009.

#### **3.1 Submissions received**

The IMO received submissions from Alinta, Aviva Corporation (Aviva), Griffin Energy, and Landfill Gas & Power (LGP). The IMO also received an out of session submission from Synergy noting support for the Rule Change Proposal.

The details of the submissions received during the first submission period are summarised below.

The full text of the public submissions is available on the IMO website.

##### **3.1.1 Submission from Alinta**

In its submission Alinta noted that it does not support the proposal as, in its opinion:

- it lacks certain benefits;
- would introduce additional complexity into the Market Rules; and
- may result in less efficient market outcomes.

In particular:

- Alinta considered that there is no evidence provided to indicate a need to amend the existing Market Rules;
- Alinta noted that the Rule Change Proposal does not indicate what constitutes a “long” lead time;
- Alinta submitted that it is implied in the proposal that the amendments are necessary to provide certainty to developers of generation projects, however the proposal would make the assignment of Capacity Credits through the ECRC mechanism contingent on the Facility being deemed to be “committed” by the IMO. In addition Alinta noted the following points:
  - the argument, in part, in support of RC\_2009\_07 was that references to “under construction” discriminated against Facilities with a short construction period that did not require to physically be constructed at least 24 months ahead of the Facility entering the market;
  - it is clear from the proposed definition of “committed” in RC\_2009\_07 that a generation project must have been subject to, and passed, a Final Investment Decision (FID); and
  - to the extent that arranging project finance for a proposed generation project is a necessary precursor to a FID, it appears that the proposed ECRC mechanism would not provide potential financiers with any greater certainty as to the assignment of Capacity Credits to the new Facility. That is, the introduction of ECRC is unlikely to have a positive effect on a Market Participant to secure financing for a proposed generation project.
- Alinta noted that the process to be followed by a Market Participant that has registered a Facility, or which intends to register as a Facility, for which it is applying for certification of Reserve Capacity is set out in clause 4.9, with information requirements set out in clause 4.10. Clause 4.11 then sets out the process that must be followed by the IMO in assigning Certified Reserve Capacity. Based on the existing provisions in the Market Rules Alinta contends that:
  - it is clear that although under the current Market Rules there may be uncertainty about the level of Capacity Credits that may ultimately be granted to a Facility there is little risk that Capacity Credits will not be assigned to a “committed” Facility;
  - uncertainty as to the level of Capacity Credits that might be assigned to a Facility by the IMO may be eliminated by applying for Conditional Certified Reserve Capacity; and
  - Conditional Certified Reserve Capacity may be sought at any time to provide certainty with respect to the level of Capacity Credits that would be assigned to a proposed Facility.

Alinta considered that to the extent that Rule Change Proposal does facilitate the entry of new generation capacity there is potential for ECRC to crowd out:

- new capacity from generation projects with relatively shorter lead times; and

- potential additional capacity from other sources that might otherwise be offered through the existing Reserve Capacity Mechanism (including additional capacity that might be available from upgrades of existing generation Facilities or Demand Side Management (DSM) programmes).

*The Rule Change Proposal and the Wholesale Market Objectives*

Alinta considered that RC\_2009\_10 is unlikely:

- to be consistent with market objectives (a) and (d) as to the extent that the propose ECRC mechanism does facilitate the entry of new generation capacity the “crowding out” of potential additional capacity from upgrades of existing generation Facilities of DSM programmes may result in inefficient and higher cost capacity entering the market;
- to facilitate efficient entry of new competitors (market objective (b)) given arranging project finance is a necessary precursor to FID and the proposed ECRC mechanism would not provide any greater certainty as to the assignment of Capacity Credits to the new Facility;
- to be consistent with market objective (c) as the proposed ECRC mechanism favours projects with longer lead time. This will result in a discrimination against particular energy options and technologies such as gas fuelled generation; and
- to affect the taking of measure to manage the amount of electricity used and when it is used (market objective (e)).

**3.1.2 Submission from Aviva Corporation**

In its submission Aviva provided support for the Rule Change Proposal on the following grounds:

- Certification of Reserve Capacity is currently designed around the construction of an Open Cycle Gas Turbine (OCGT) which is notionally a two year timeframe. Aviva considered that this is arbitrary and was initially designed for simplicity based on the concept that addition of an OCGT was the default option for new capacity;
- Certification is required for any generation Facility to enable it to operate in the Wholesale Electricity Market (WEM) but also as a prelude to being allocated Capacity Credits in an applicable Capacity Year;
- The current timing for Certified Reserve Capacity:
  - Does not take into account longer actual development/construction times for some complex OCGT’s; and
  - Seems to be inadequate for base load plant, particularly coal fired power stations with construction in excess of two years;
- Aviva noted that Conditional Certification is a helpful mechanism for longer lead time plant but does not guarantee either full certification or allocation of Capacity Credits to

the Facility. Certainty is only available if the Facility is considered by the IMO to be “under construction” when bilateral trade declarations are submitted around 10 August each year;

- Aviva asserted that in difficult investment climates funding institutions have flagged the need to de-risk projects as much as possible. For long lead time projects Aviva contended that at the proposed financing event, under the current Market Rules, only Conditional Certification would be available to the Facility, despite the fact that the project would be able to satisfy all the requirements for a committed project; and
- At the time of financial close, funding institutions would have to be comfortable with the risk that the Facility may not be allocated Capacity Credits for the applicable Capacity Year.

Aviva submitted that it strongly supports the Rule Change Proposal to allow ECRC for new Facilities. In particular, Aviva contended that the proposal will provide substantial benefits by granting long lead time projects the same certainty for certification and allocation of Capacity Credits as shorter lead time projects.

Aviva also noted that it supports the retention of Conditional Certification for projects. This was on the basis that it does flag to potential investors, and the market, the intention of the developer in regard to the project and signal its progress to achieve certification.

### **3.1.3 Submission from Griffin Energy**

In its submission, Griffin Energy submitted that the proposal is a sensible measure to differentiate capacity in the Market Rules that is physically different by nature. In particular, Griffin Energy noted that the current settings require proponents to make investment decisions on long lead time generation Facilities before Capacity Credits can be secured.

Griffin Energy noted that while current generation technology dictates that long lead time Facilities are generally larger Facilities, that rely on long term bilateral contracts (and hence do not require Capacity Credit certainty for financing – as Capacity Credit risk is shared by the bilaterally contracting parties), it is desirable to mitigate this risk by creating certainty before bilateral negotiations are likely to be concluded.

Griffin Energy contended that it is also prudent to assume that new technology (that might be more reliant on Capacity Credit revenue to secure finance) might benefit from the extended timeframes, as by its nature, new technology Facilities will likely require longer lead times for a successful project development.

#### **The Rule Change Proposal and the Wholesale Market Objectives**

Griffin Energy submitted that promoting more certainty for long lead time Facilities will:

- likely lead to a more economically efficient mix of generation investment in the SWIS (market objective (a));
- lead to more competition and facilitate efficient entry of new competitors, as new competitors of generation Facilities that are not typified by those which can be

developed in the current timeframes will gain more traction in the market (market objective (b)); and

- remove an inherent discrimination against new generation Facilities requiring long development lead times (market objective (c)).

### **3.1.4 Submission from Landfill Gas & Power**

LGP supported the Rule Change Proposal on the grounds that it facilitates the financing of long lead time generation projects.

In its submission LGP questioned whether clause 4.28C.1 may not achieve the anticipated outcome on the grounds that a Facility is unlikely to be committed prior to receipt of certification/credits. LGP contends that it would be more constructive to:

- separate capacity certification from the allocation of Capacity Credits (as at present); and
- make only the allocation of credits conditional on commitment after certification has been granted.

LGP perceived that such an amendment would be minor but would preserve the intent.

#### *The Rule Change Proposal and the Wholesale Market Objectives*

LGP submitted that it would also support market objective (a) as the rule favours long lead time generators, which may be expected to have lower production costs.

LGP agreed with the IMO's contention that the proposed changes will allow the Market Rules to better address market objective (b).

### **3.3 The IMO's assessment of First Submission period responses**

The IMO received three responses in favour of the Rule Change Proposal during the first submission period. In particular, Aviva, Griffin Energy, and LGP (while questioning one aspect) were supportive of the proposal on the grounds that it will facilitate the financing of long lead time projects.

Alinta did not support RC\_2009\_10 as it considered that the Rule Change Proposal lacks certain benefits, would introduce additional complexity into the Market Rules, and may result in less efficient market outcomes.

The IMO responded to each of the issues raised during the first submission period in the Draft Rule Change Report. For further details please refer either to the Draft Rule Change Report or Appendix 2 of this report.

### **3.4 Public Forums and Workshops**

No public forums or workshops were held in relation to this Rule Change Proposal.

### 3.5 Additional Amendments

During the first public submission period the IMO considered that some changes to the proposed Amending Rules were required to improve the drafting.

These changes are as follows (~~deleted text~~, added text):

4.11.1. Subject to clause 4.11.7, the IMO must apply the following principles in assigning a quantity of Certified Reserve Capacity to a Facility for the Reserve Capacity Cycle to which the application relates:

...

(c) the IMO must not assign Certified Reserve Capacity to a Facility for a Reserve Capacity Cycle if:

...

iv. that Facility already has Capacity Credits assigned to it under Clause 4.28C for the Reserve Capacity Cycle.

The following proposed amendment to clause 4.11.1.(c).iv. is conditional on the outcome of the RC 2009 11 – Changing the Window of Entry into the Reserve Capacity Market. In the case that RC 2009 11 is not approved by the IMO the proposed new clause 4.11.1.(c)(iv) will become clause 4.11.1(c)(iii).

4.15.1. If the information provided under clauses 4.14 and 4.28C indicates that no Certified Reserve Capacity is to be made available in the Reserve Capacity Auction for a Reserve Capacity Cycle, or, based on the information received under clause 4.14, the IMO considers that the Reserve Capacity Requirement for the Reserve Capacity Cycle will be met without an auction, then, by the date and time specified in clause 4.1.16, the IMO must publish a notice specifying for that Reserve Capacity Cycle:

- (a) that the Reserve Capacity Auction has been cancelled;
- (b) the Reserve Capacity Requirement;
- (c) the total amount of Certified Reserve Capacity;
- (cA) the Capacity Credits assigned under clause 4.28C;
- (d) the total amount of Certified Reserve Capacity that would have been made available in the Reserve Capacity Auction had one been held; and
- (e) the total amount of Certified Reserve Capacity covered by pre-existing Special Price Arrangements;

#### **4.28C. Early Certification of Reserve Capacity**

4.28C.8. Within 30 Business Days of the applicant receiving notification by the IMO of the amount of Early Certified Reserve Capacity assigned to the Facility the applicant must provided Reserve Capacity Security equal to the amount specified in clause 4.28C.9., else the Early Certified Reserve Capacity assigned to the Facility will lapse.

4.28C.10. The IMO must set the Capacity Credits for the Facility to equal the Early Certified Reserve Capacity of the Facility once the Reserve Capacity Security is provided to the IMO under clause 4.28C.8.

4.28C.12. The Reserve Capacity Security provided by the Market Participant under Gclause 4.28C.4 (b) must, by the time and date in clause 4.1.13 (a), in year 1 of the first Reserve Capacity Cycle in which the Facility will commence operation be recalculated in accordance with 4.28C.9, and the difference paid to the IMO or refunded to the Market Participant as applicable,

### **Appendix 3: Reserve Capacity Auction & Trade Methodology**

...

- o For the testing of bilateral trades, for Availability Class  $a = 1$  this is the greater of zero and  $Q[a] - X[a]$  while for Availability Classes  $a = 2, 3$  or  $4$ , this is the greater of zero and  $(Q[a] - X[a] - Y[a-1])$  where

$Q[a]$  is the quantity associated with Availability Class “a” in clause 4.5.12(c).

$X[a]$  is the total quantity of:

- i        Certified Reserve Capacity to be provided by Facilities subject to Network Control Service Contracts and by Facilities under Long Term Special Price Arrangements during the period to which the Reserve Capacity Requirement applies; plus
- ii ~~¶~~ the amount of Capacity Credits assigned under clause 4.28C for the period to which the Reserve Capacity Requirement applies

where the capacity is certified as belonging to Availability Class “a” and is not subject to a bilateral trade.

$Y[a]$  represents the amount by which  $(X[a] + Y[a-1])$  exceeds  $Q[a]$ , with the exception that  $Y[0] = 0$ .

...

## 4. THE IMO'S DRAFT ASSESSMENT

The IMO's assessment, as contained in its Draft Rule Change Report, can be viewed on the IMO's website.

## 5. THE IMO'S DRAFT DECISION

Based on the matters set out in the Draft Rule Change Report, the IMO's draft decision, in accordance with clause 2.7.7(f) was to accept the proposed amendments to 4.1.1A, 4.5.2, 4.9.3, 4.11.1, 4.12.6, 4.15.1, 4.15.2, Chapter 11 Glossary and Appendix 3, and the addition of clauses 4.28C, 4.28C.1, 4.28C.2, 4.28C.3, 4.28C.4, 4.28C.5, 4.28C.6, 4.28C.7, 4.28C.8, 4.28C.9, 4.28C.10, 4.28C.11, 4.28C.12, 4.28C.13, 4.28C.14, 4.28C.15 of the Market Rules as proposed in the Rule Change Proposal and amended following the first submission period.

The IMO made its decision on the following basis:

- The Amending Rules:
  - allow the Market Rules to better address Wholesale Market Objectives (a) and (b);
  - are consistent with the remaining Wholesale Market Objectives;
  - had the support of the MAC for its progression through the rule change process; and
  - had the support of the majority of submissions during the first submission period.

## 6. SECOND SUBMISSION PERIOD

Following the publication of the Draft Rule Change Report on the IMO website, the second submission period was between 8 July 2009 and 4 August 2009.

### 6.1 *Submissions received*

The IMO received submissions from ANZ, Alinta and LGP.

The details of the submissions received during the second submission period are summarised below. The full text of the public submissions is available on the IMO website.

#### 6.1.1 *Submission from Alinta*

In its submission Alinta notes that it does not support RC\_2009\_10 and remains of the view that the Rule Change Proposal lacks demonstrable benefits, would introduce additional complexity into the Market Rules, and may result in less efficient market outcomes.

In particular, Alinta notes the observable evidence is that the existing Reserve Capacity mechanism and the current Reserve Capacity Cycle have successfully delivered the Reserve Capacity Requirement determined for each Capacity Year to date. Alinta contends that no

evidence is included in the Rule Change Proposal to support a conclusion that the existing arrangements could not reasonably be expected to continue to ensure sufficient capacity is delivered to the market.

Further Alinta contends that it is implied in RC\_2009\_10 that the amendments to the Market Rules being contemplated are necessary to provide certainty to developers of generation projects with 'long lead times' and would "...*have a positive effect on the ability...to secure financing...*". Alinta contended in its first submission, the assignment of Capacity Credits through the ECRC mechanism would remain contingent on the Facility being deemed to be 'committed' by the IMO, which implies a FID had been made and hence project finance would also already have been arranged. In the Draft Rule Change Report the IMO noted that arranging project finance is not a necessary precursor to a FID, but often occurs in parallel. In its submission Alinta notes that it is not able to comment on this claim, but based on the totality of factors identified as those that the IMO will take into consideration when assessing whether a project is 'committed', a project developer would have to have a significant appetite for risk if it were able to satisfy the IMO that the project was 'committed' in the absence of having arranged financing.

Alinta also makes comments/observations on the following points noted by the IMO in its Draft Rule Change Report:

- impact on project risk; and
- Market Advisory Committee Support,

These comments and observations are presented below.

#### Impact on project risk

Alinta notes that one submission supported the proposed rule change on the basis that:

*"...in difficult investment climates funding institutions have flagged the need to de-risk projects as much as possible. For a long lead time projects Aviva contends that at the proposed financing event, under the current Market Rules only Conditional Certification would be available to the Facility, despite the fact that the project would be able to satisfy all the requirements for a committed project; and at the time of financial close, funding institutions would have to be comfortable with the risk that the Facility may not be allocated Capacity Credits for the applicable Capacity Year."*

Similarly, Alinta notes that another submission supported the Rule Change Proposal on the grounds that it would facilitate the financing of long lead time generation projects.

In its submission Alinta contends that in this context, the IMO's draft Rule Change Report clearly states that "...*committed Facilities that declare their intention to trade bilaterally are guaranteed Capacity Credits*" Hence under the existing Market Rules, there would not appear to be any risk that a committed project will not receive Capacity Credit.

As a result, Alinta considers that it appears disingenuous to claim that the Rule Change Proposal would make projects with long lead times become financially viable by providing a

surety of income, and would remove both a barrier to entry under the current Market Rules and a discriminatory limitation on long lead time projects.

#### Market Advisory Committee support

Alinta states that the IMO claimed that the concept paper and Rule Change Proposal received the support of the MAC at the February and April 2009 meetings respectively. Alinta considers that the minutes of these meetings do not support this claim.

#### Potential Alternative Approach

In its submission Alinta proposes a potential alternative approach of including a mechanism within the Market Rules that allows potential developers of new Facilities to seek confirmation from the IMO that a project is 'committed'.

Alinta suggests that such a mechanism could:

- eliminate any perceived risk on the part of a developer that the proposed new Facility may not receive Capacity Credits in a future Reserve Capacity Cycle;
- be consistent with, and complement, the Conditional Certified Reserve Capacity mechanism, which provides certainty with respect to the level of Capacity Credits that would be assigned to a proposed Facility; and
- operate alongside the existing Reserve Capacity Cycle which would be significantly preferable to proceeding with RC\_2009\_10 as currently proposed. This is because it would:
  - be fit for purpose (i.e. it directly eliminates any perceived risk around whether a project is 'committed' or not ahead of the current Reserve Capacity Cycle);
  - would avoid introducing additional complexity into the Market Rules; and
  - avoid the risk of unintended consequences that could potentially arise from establishing ECRC as a new concept in the Market Rules as envisaged by RC\_2009\_10.

#### The Rule Change Proposal and the Wholesale Market Objectives

As noted in its first submission, Alinta considers that the IMO cannot be satisfied that the Market Rules, as proposed to be amended or replaced by RC\_2009\_10, are consistent with all the above Wholesale Market Objectives.

- RC\_2009\_10 is unlikely to be consistent with Market Objective (c). If the proposed ECRC mechanism favours projects with longer lead time, this is likely to result in discrimination against particular energy options and technologies as coal fuelled generation tends to have longer project lead times compared with gas fuelled generation.

- RC\_2009\_10 is unlikely to be consistent with Market Objectives (a) and (d). To the extent that the proposed ECRC mechanism does facilitate the entry of *new* generation capacity as claimed by the IMO, the 'crowding out' of potential additional capacity from upgrades of existing generation facilities or to Demand Side Management Programmes may result in inefficient and higher cost capacity entering the market.

Alinta also submitted that while RC\_2009\_10 may not be inconsistent with Market Objectives (b) and (e):

- It is unlikely to facilitate efficient entry of new competitors [Market Objective (b)] given arranging project finance is generally a *precursor* to a FID and the proposed ECRC mechanism would not provide any greater certainty as to the assignment of Capacity Credits to the new Facility.
- It is unlikely to affect the taking of measures to manage the amount of electricity used and when it is used.

### **6.1.2 ANZ**

In its submission ANZ agreed with the IMO's proposed changes and with its rationale for the changes. ANZ submitted that banks expect to see conditional certification as a sign the deal will progress, but that banks wouldn't generally provide funding for the project unless certification was confirmed as a minimum, as there would still be a level of perceived project risk..

ANZ states that whilst debt might commit to a project, the bank will not generally provide any money until certification is confirmed. In a worst case scenario, debt commitments might collapse if confirmation of certification can not be provided within an agreed timetable, meaning equity may have committed and be substantially spent but the debt would be tied to provision of Capacity Credits. ANZ contends that this provides a higher level of equity risk, even if investors are confident that a deal meets all the requirements.

Additionally, ANZ notes in its submission that banks generally structure around regulatory risk (including approvals) and ensure that that is put to equity.

ANZ states that anything which would support investors in the market by confirming certification or even allocation will assist in the provision of debt. Further, ANZ submitted that more generally, as an islanded market, the proposed changes will maximise the technology choices available to investors.

### **6.1.3 Submission from Landfill Gas & Power**

LGP submitted that it supports the IMO's analysis and decision to proceed with the Rule Change after having reviewed the IMO's Draft Rule Change Report.

## **6.2 The IMO's assessment of Second Submission period responses**

The IMO received submissions in favour of the Rule Change Proposal from ANZ and LGP during the second submission period. Alinta however did not support RC\_2009\_10 as it

continues to consider that the Rule Change Proposal lacks certain benefits, would introduce additional complexity into the Market Rules, and may result in less efficient market outcomes.

The IMO has responded to each of the issues identified during the second submission period below:

- Alinta contends that no evidence is included in the Rule Change Proposal to support a conclusion that the existing arrangements could not reasonably be expected to continue to ensure sufficient capacity is delivered to the market.

The IMO reiterates that discussions held with Market Participants and potential developers initially determined that the 28-month reserve capacity cycle does not adequately accommodate projects which are subject to long lead times. It was in response to these discussions that the concept of ECRC has been developed.

The IMO also notes proposed changes received the support of the majority of submitters during the first submission period. Furthermore, the discussions held at the public workshop and the subsequent informal submissions reinforce the importance of greater certainty around the Capacity Credits for long lead time projects. Further details of the public workshop are available in section 7 of this report.

The IMO notes that the proposed changes will allow projects with long lead times to secure finance by providing evidence of a surety of income. This removes one of the obstacles which project developers face when developing long lead time projects and will consequently remove a current barrier to entry into the market.

- Alinta notes that it is not able to comment on the IMO's claim in the Draft Rule Change Report that arranging project finance is not a necessary precursor to FID but rather occurs in parallel. However based on the totality of factors identified as those that the IMO will take into consideration when assessing whether a project is 'committed', Alinta contends that a project developer would have to have a significant appetite for risk if it were able to satisfy the IMO that the project was 'committed' in the absence of having arranged financing.

The IMO does not agree with Alinta's statement. In particular the IMO ANZ's submission which confirm that whilst debt might commit to a project, the bank will not generally be providing money until certification is confirmed. Further in its submission following the public workshop, ANZ provides an example of a worst case scenario where debt commitments collapse if confirmation of certification can not be provided within an agreed timetable. This means that while equity may have committed and be substantially spent, the debt would be tied to the provision of Capacity Credits.

- Alinta quotes the IMO's Draft Rule Change Report which states that "... *committed Facilities that declare their intention to trade bilaterally are guaranteed Capacity Credits*" and contends that this implies that under the existing Market Rules, there would not appear to be any risk that a committed project will not receive Capacity Credits. Alinta state that as a result, its appears disingenuous to claim that the Rule Change Proposal would make projects with long lead times become financially viable by providing a surety

of income and removing both a barrier to entry under the current Market Rules and a discriminatory limitation on long lead time projects.

In response, the IMO notes that a committed project is not automatically guaranteed Capacity Credits. In particular a committed project is only guaranteed Capacity Credits when a declaration to trade bilaterally has been made, which requires a project to have been granted Certified Reserve Capacity. It is only under the circumstance where a committed project has been granted Certified Reserve Capacity that Capacity Credits will be guaranteed.

- Alinta considers that the minutes of the February and April 2009 MAC meetings did not provide evidence that the concept paper and Rule Change Proposal received the support of the MAC.

The IMO notes that Alinta correctly identified an incorrect statement regarding the MAC's support of the Amending Rules in the Draft Rule Change Report. The IMO agrees that the Draft Rule Change Report should have more clearly stated that the Rule Change Proposal had the support for the MAC to be progressed as a rule change.

An overview of the views expressed by the MAC where the committee met to consider the Rule Change Proposal is provided in section 8.4 of this report. For greater clarification of the MAC's views on the proposal a summary is provided below:

- December 2008 – Concept Paper presented to the MAC. The approved minutes from the meeting note that all MAC members expressed support for providing long lead time projects greater certainty of income earlier in the process than currently provided for under the Market Rules.
- MAC submissions on the Concept Paper - Following the presentation of the concept paper to the MAC the IMO requested submissions from MAC members. The IMO received a submission from Alinta questioning whether the changes would provide financiers with any greater certainty than currently exists.
- February 2009 - Updated Concept Paper presented to the MAC. A member asked the IMO to consider whether it is unreasonably onerous to require a Facility be “under construction” before it can apply for ECRC and also require it to file the security deposit before it is granted Capacity Credits.
- April 2009 – Rule Change Proposal presented to the MAC. Noted by members and agreed that the IMO progress the proposal through the rule change process.

While acknowledging Alinta's comments on the MAC's support of the Amending Rules, the IMO confirms its decision to proceed with the proposal as a rule change, as based on discussion held at the MAC.

- Alinta provides a suggested alternative approach to include a mechanism within the Market Rules that allows potential developers of new Facilities to seek confirmation from the IMO that a project is “committed”. Further details of the proposed mechanism are provided in section 6.1.1.

In response to Alinta's suggested alternative, the IMO considered that the proposed mechanism was worthy of discussion with industry and so determined to hold a public workshop. The IMO notes that while the alternative mechanism would be consistent with, and complement the Conditional Certified Reserve Capacity mechanism and operate alongside the existing Reserve Capacity Mechanism, the IMO and participants at the workshop do not consider that it would eliminate the perceived risk for project developers as to whether they will receive Capacity Credits. Consequently, the IMO does not consider that this alternative approach would meet the intent of the rule change in terms of providing greater certainty around the provision of Capacity Credits for long lead time projects.

- Alinta considers that the proposal is unlikely to be consistent with market objective (c). This is because the ECRC mechanism favours projects with longer lead times which will result in a discrimination against particular energy options and technologies such as gas fuelled generation.

The IMO considers that the proposed changes will remove a current discrimination against longer lead time projects. The IMO notes that the proposed changes will allow for a more equivalent treatment of all new generation projects.

- Alinta considers that the proposal is unlikely to be consistent with market objectives (a) and (d) in relation to crowding out alternative capacity from upgrades or DSM programmes which may result in inefficient and higher cost capacity entering the market.

The IMO considers that the proposed changes would not result in the crowding out of alternative capacity as all Capacity Credit providers, regardless of technology, will be able to enter the market if they declare an intention to trade bilaterally. Additionally, all committed Facilities will be entitled to receiving Capacity Credits from the date they are committed. The IMO also notes that energy producing plants are most likely to already be in a situation of having a Bilateral Contract and that this is no different to the current situation.

The IMO contends that the proposed changes will improve the transparency and certainty for developers of energy providing plant making decisions.

- Alinta considers that while the proposal may not be inconsistent with market objective (b) it is unlikely to facilitate efficient entry of new competitors. This is because arranging project finance is generally a precursor to a FID and the proposed ECRC mechanism would not provide any greater certainty as to the assignment of Capacity Credits to the new Facility.

The IMO considers that the proposed changes will make receiving Capacity Credits easier once a Facility is committed. The IMO notes that often arranging project finance and FID occur in parallel. The IMO reiterates that ECRC will mean that new entrant generators will be able to enter the market with a reduced level of financial risk. The IMO also notes that this was emphasised by Aviva at the public workshop (refer to the section 7 for further details).

- Alinta considers that while the proposal may not be inconsistent with market objective (e) it is unlikely to affect the taking of measures to manage the amount of electricity used and when it is used.

The IMO notes that the intent of the Rule Change Proposal is to reduce the risk around receiving Capacity Credits for long lead time projects and not to impact on the amount of electricity used and when it is used. The IMO agrees with Alinta that the rule change will not impact on this. The IMO considers that the proposed changes are consistent with market objective (e).

## 7. PUBLIC WORKSHOP

In response to the suggested alternative method Alinta during the second submission period, the IMO extended the timeframe for preparing the Final Rule Change Report. During the extension, the IMO held a workshop on 24 August 2009 to review the proposed alternative and discuss any further issues raised.

The workshop was attended by a range of Market Participants:

- |                                 |                     |
|---------------------------------|---------------------|
| • Alinta                        | • Synergy           |
| • Economic Regulation Authority | • System Management |
| • Griffin Energy                | • Verve Energy      |
| • IMO                           | • ERM Power         |
| • Landfill Gas and Power        | • Premier Power     |
| • Perth Energy                  | • Aviva Corporation |

The workshop demonstrated a high level of engagement from industry and in particular provided a forum for:

- the IMO to present the proposed ECRC process;
- Alinta to put forward its reasons for proposing the alternative method; and
- Market Participants views to be heard and queries to be addressed.

As an outcome of these discussions the IMO invited Market Participants to provide additional informal submissions on the proposal in order for the IMO to make its final decision.

A copy of the full workshop minutes is available on the IMO website.

### 7.1 *Informal submissions received following public workshop*

The IMO requested participants to make further informal submissions on the Rule Change Proposal in light of the discussions held during the workshop which would be taken into account in making its final determination. The IMO received additional submissions from Aviva, Griffin Energy, LGP and Perth Energy. A summary is provided below, with the full details available on the IMO's webpage.

### **7.1.1 Aviva Corporation**

In its submission following the public workshop, Aviva provides support for the original Rule Change proposal and the IMO's Draft Rule Change Report as a sensible and targeted approach to addressing a real problem for developers of long lead time generation projects.

Aviva submitted that it is not convinced that Alinta's "alternative" suggestion addresses the core issue around providing added certainty for financing of long lead projects which by their nature fall outside the normal two-year Capacity Cycle designed for open cycle gas turbines.

Aviva notes that the Rule Change Proposal was initiated based on real world experience of project development in this market, especially around more complex projects which are likely to require a development timetable beyond the two-year window built into the current framework.

In particular, Aviva considers that it allows the project developer to "work backwards" from the point at which the market requires commercial capacity/energy (primarily based around the needs of the off-taker) back to the financing event that immediately precedes Notice to Proceed for the EPC contractor. Furthermore, Aviva notes that the rule change allows the project developer to secure project approvals, off-take arrangements, EPC supplier and financing with the added certainty of securing future capacity credits in an achievable timeframe.

Aviva submitted that in a broad sense, all the rule change is in effect doing is moving the window of being assigned capacity credits out from two years to an earlier point, which fits in with a realistic timeframe for development of complex long lead projects. Aviva notes that other than moving the window for obtaining capacity credit certainty, there are no other concessions for long lead time projects. Specifically, all the current requirements for being assigned capacity credits will continue to apply, and IMO will still go through its assessment, and then require a security deposit.

Aviva states that in reality, these projects face very harsh scrutiny from financiers because of the high capital cost and longer construction timeframe. Aviva notes that without the proposed rule change, there is an added level of uncertainty regarding being assigned future capacity credits at the time of FID and/or financial close and this is at the very point that financiers weigh up whether or not to lend capital to the developers. Addressing that uncertainty through the proposed rule change is both warranted and good for the market.

### **7.1.2 Griffin Energy**

In its additional submission, Griffin Energy continues to support RC\_2009\_10 in its current form.

Griffin Energy notes that while it had previously submitted on this proposal during the first submission period it wished to make the following additional comment in light of the public workshop:

*While the alternative proposal presented at the workshop was obviously well thought through, Griffin Energy does not believe that it produces a solution to the same level of completeness to that being provided by RC\_2009\_10.*

In addition Griffin notes that one of the most difficult barriers facing new entrant generation proponents is in gaining the early support of financiers, suppliers and off-take counterparties. Proponents often undertake substantial project development and equity funding risk to move a project to the stage where it can gain adequate financing; or to where it can convince creditworthy counterparties that it is a credible project worth entering a long term off-take with.

Griffin Energy contends that securing capacity credits, which demonstrates that the project is categorised as forming part of the “official” generation supply in the SWIS for the relevant year, goes a long way to securing this early support. Quantifying the benefit of this is difficult – it is often an intangible value. Indeed, projects holding capacity credits are not immune from failure. However it is likely that the award of firm capacity credits earlier in a project’s development will lead to a more diverse array of projects (and proponents) entering the market.

### **7.1.3 Landfill Gas & Power**

In its submission LGP notes that it has reviewed the IMO’s Draft Rule Change Report and supports the IMO’s analysis and decision to proceed with the Rule Change Proposal.

LGP notes its attendance of the public workshop for further discussion the Rule Change Proposal. LGP considers that based on the submissions by Alinta, Griffin Energy, Aviva and commentary by the IMO on its discussions with ANZ bank during the public workshop, it finds no reason to change its position.

Furthermore, in its submission LGP states that it considers that participation of capital intensive generation delivering low average cost power is a principal strategy for lowering the cost of electricity to consumers, which is at the core of the Market Objectives. LGP acknowledges that such projects, and in particular baseload, may have lead times in excess of the development periods contemplated by the Reserve Capacity Mechanism to the point that financiers may have to commit significant capital to a project before the allocation of capacity credits is certain. LGP considers that this exposes the financier to considerable risk during the commitment of the initial capital and the allocation of credits, which period could be 2 to 3 years.

LGP notes that while it acknowledges Alinta’s assessment of the risk within the current and proposed rules, it considers that from the financier’s perspective, the principal risk is regulatory - that the rules might change during the period of exposure. LGP notes that this is a particular concern within the current political context.

In addition, LGP notes that there is additionally the factor that the financier would have to fully understand the Market Rules and monitor any changes to them during the period of exposure. LGP considers it to be far more effective to allocate capacity credits at the time of financial commitment and on that basis supports the rule change.

### **7.1.4 Perth Energy**

In its submission Perth Energy provided support for the proposal.

Perth Energy notes the key point is that a Market Participant is committing a very large amount of money when it decides to build a power station. Before committing this amount of money, the Market Participant, and its financiers, will need to be assured that they are able to secure

certification and to secure Capacity Credits. At present, this can essentially be achieved by securing conditional certification. Perth Energy however notes that there is not an absolute guarantee that the facility will ultimately be given “full” certification because there may have been a change in some aspect of the project.

In its submission Perth Energy notes that if when the Market Participant applies for “full” certification, the information is “not consistent” with the conditional certification then the process must be restarted. Investors do not know what constitutes “not consistent”. In particular Perth Energy poses the following questions around what may happen if there is:

- A change of ownership structure?
- A change of equipment supplier?; or
- A change in some technical factor such as the loading rate?

Perth Energy contends that because of these considerations conditional certification does not automatically lead to “full” certification and so does not give the level of certainty that investor’s desire.

Perth Energy notes that the original intention was that conditional certification would provide the level of certainty that investors desire when making commitments to build a generator that has a long lead time. Perth Energy contends that because conditional certification is now not fulfilling this intention, there is little benefit in retaining the concept of conditional certification.

In its submission Perth Energy also provides the following reasons for supporting the proposal:

- The global financial crisis has seen several major banks withdraw from the power market and others are coming in to take their place. This means that there has been a change-over in staffing, credit committees and management. The market is therefore now working with people who do not have the same background as in the past. On this basis Perth Energy considers that to say that financiers have developed an understanding that “conditional” certification is virtually as secure as “full” certification is erroneous;
- The moves towards emissions trading are causing great uncertainties within the industry. There is a school of thought that infrastructure investors now prefer non-energy investments such as toll-roads or airports as they are seen to have lower risk. Perth Energy considers that changing the rules on conditional certification is one way of restoring the risk profile of power generation;
- While Alinta notes that there has not been any shortfall in new capacity coming forward, Perth Energy considers it is unclear how the market will go forward. Perth Energy contends that the latest figures for assignment of capacity credits is promising but the market also needs to be capable of drawing in capacity during times when investors are not as positive; and
- One major benefit to “full” certification occurring early is that this information will be available to other investors early. Other investors will know whether a certain proposal is

committed and this will allow them to tailor their own plans to take this into account. Perth Energy considers that this may well “spread” investment out so that the amount of capacity in the system better matches the capacity requirement.

## 8. THE IMO’S FINAL ASSESSMENT

In preparing its Final Rule Change Report, the IMO must assess the Rule Change Proposal in light of clauses 2.4.2 and 2.4.3 of the Market Rules.

Market Rule 2.4.2 outlines that the IMO “*must not make Amending Rules unless it is satisfied that the Market Rules, as proposed to be amended or replaced, are consistent with the Wholesale Market Objectives*”.

Additionally, clause 2.4.3 states, when deciding whether to make Amending Rules, the IMO must have regard to the following:

- Any applicable policy direction from the Minister regarding the development of the market;
- The practicality and cost of implementing the proposal;
- The views expressed in submissions and by the MAC; and
- Any technical studies that the IMO considers necessary to assist in assessing the Rule Change Proposal.

The IMO notes that there has not been any applicable policy direction from the Minister in respect of this Rule Change nor has it commissioned a technical review in respect of this Rule Change Proposal.

The IMO’s assessment is outlined in the following sections.

### 8.1 Market Objectives

The IMO considers that the Market Rules as a whole, if amended, will be consistent with the Wholesale Market Objectives.

Wholesale Market Objective	Consistent with objective
(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system	Yes
(b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors	Yes
(c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options	Yes

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	Yes
(e) to encourage the taking of measures to manage the amount of electricity used and when it is used	Yes

Further, the IMO considers that the Market Rules if amended would not only be consistent with the Wholesale Market Objectives but also allow the Market Rules to better address Wholesale Market Objectives (a) and (b):

Impact	Wholesale Market Objectives
Allow the Market Rules to better address objective	a, b,
Consistent with objective	c, d, e

The IMO's assessment against market objective (a) is as follows:

- (a) *to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;*

The proposed changes will support market objective (a) by facilitating the efficient entry of new competitors which will likely lead to a more economically efficient combination of generation investment as the proposed changes target generators with long lead times.

The IMO's assessment against market objective (b) is as follows:

- (b) *to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors;*

The proposed changes will support market objective (b) by facilitating the entry of new generation Facilities with long lead times as it will add certainty to the income stream around Capacity Credits. It is expected that this will have a positive effect on the ability of a Market Participant to secure financing for new generation.

The IMO considers that the proposed changes are consistent with the other market objectives.

## **8.2 Practicality and cost of implementation**

The proposed changes will also require some changes to the Wholesale Electricity Market Systems operated by the IMO. It has been estimated that the associated changes to Wholesale Electricity Market Systems operated by the IMO will cost approximately AUD \$30,000 - \$50,000.

The proposed changes were evaluated to ensure there were no modifications required to the settlement systems. No changes were identified.

### **8.3 Views expressed in submissions**

#### First Submission Period

Of the four formal submissions received during the first submission period, Aviva, LGP and Griffin supported the proposal. The main supporting reason was that the Rule Change Proposal facilitates the financing of long lead time generation projects by removing an inherent discrimination in the Market Rules.

In its submission LGP did however question whether clause 4.28C.1 may not achieve the anticipated outcome as a Facility is unlikely to be committed prior to receipt of certification.

Alinta did not support the proposed changes. In particular, Alinta noted that it considers that the Rule Change Proposal lacks certain benefits, would introduce additional complexity into the Market Rules, and may result in less efficient market outcomes.

The IMO's response to the issues raised in submissions from Alinta and LGP are contained in appendix 2 of this report. The IMO did not consider that any of the points raised provided sufficient evidence that the proposed changes would not have the anticipated effect.

#### Second Submission Period

During the second submission period the IMO received submissions from ANZ, Alinta and LGP.

In its submission LGP supported the IMO's decision to proceed with the proposed changes and the IMO's assessment. Likewise, ANZ agreed with the IMO's proposed changes and with its rationale for the changes.

Alinta continued to not support the proposed changes. In its submission Alinta remained of the view that the Rule Change Proposal lacks demonstrable benefits, would introduce additional complexity into the Market Rules, and may result in less efficient market outcomes. In its submission Alinta also presented a potential alternative approach of including a mechanism within the Market Rules that allows potential developers of new Facilities to seek confirmation from the IMO that a project is 'committed'.

The IMO's responses to the issues raised during the second submission period are provided in section 6.2 of this report. The IMO does not consider that any of the points raised provided sufficient evidence that the proposed changes will not have the anticipated effect. The IMO did however consider that there was benefit in discussing Alinta's proposed alternative approach. As a result the IMO held a public workshop to consider the proposal further. Additional details are available in section 7 of this report.

#### Post- Workshop Submissions

As an outcome of the public workshop to discuss RC\_2009\_10 and in particular Alinta's suggested alternative approach, the IMO invited participants to provide further comments on the proposed changes.

The four submissions received in response to the public workshop provided support for the IMO's proposed changes. In particular, the submissions highlight that the proposed ECRC process will eliminate the uncertainty currently associated with developing long lead time projects. In particular, Griffin notes that while Alinta's proposed alternative was well thought through it would not produce a solution to the same level of completeness as that proposed currently under RC\_2009\_10. Further, Perth Energy notes that under the current conditional certification process there is not an absolute guarantee that the facility will ultimately be given "full" certification because there may have been a change in some aspect of the project.

#### **8.4 Views expressed by the Market Advisory Committee**

The MAC met to discuss the proposal at various stages:

- 10 December 2008: Concept Paper (CP\_2008\_01);
- 11 February 2009: Concept Paper (CP\_2009\_01); and
- 29 April 2009: Rule Change Proposal (RC\_2009\_10).

An overview of the discussion from the various MAC meetings is presented below. Further details are available in the MAC meeting minutes available on the IMO website:

<http://www.imowa.com.au/market-advisory-committee>

##### **December 2008 MAC meeting**

The IMO first presented the ECRC concept to the MAC at the 10 December 2008 meeting. In particular, the concept paper (CP\_2008\_01) presented the merits of extending the timeframe associated with building projects (currently 28 months) in order to provide additional security to project developers by removing Conditional Certification and replacing it with guaranteed CRC when a Facility meets the eligibility criteria.

All MAC members expressed support for extending the timeframe associated with building projects, which will allow for long lead time projects to secure Capacity Credits earlier. MAC members were also provided an opportunity to make an out of session submission on the concept to the IMO. The IMO received a submission from Alinta questioning whether the changes proposed would provide financiers with any greater certainty than already exists under the existing arrangements. The IMO also received informal feedback from discussions with new entrant generators suggesting that Conditional Certification is useful when acquiring project finance.

In response, the IMO decided to maintain the concept of Conditional Certification and, as previously proposed, seek to introduce the new concept of receiving ECRC to the Market Rules. The IMO presented these additional considerations to the MAC in an updated concept paper (CP\_2009\_01) for discussion at the 11 February 2009 meeting

##### **February 2009 MAC meeting**

The outcomes of the IMO's further assessment were presented to the MAC. At the meeting it was noted that ECRC is "normal" CRC, except that it is to be approved earlier than current timeframes allow. This is still contingent on Facilities being committed.

A member asked the IMO to consider whether it is unreasonably onerous to require a Facility to be "under construction" before it can apply for ECRC and also require it to file the security deposit before it is granted Capacity Credits. It was noted that this was to replicate the existing provisions for normal CRC and to provide an appropriate level of certainty, as granting Capacity Credits early represents a commitment on behalf of the market.

### **April 2009 MAC meeting**

The IMO presented the Rule Change Proposal for noting by MAC members. Given that the concepts were discussed at two previous MAC meetings and has received support for its progression, the MAC agreed that it was not necessary to discuss the detailed contents of the Rule Change Proposal again.

The MAC agreed that the IMO progress the paper through the Rule Change Process.

## **9. THE IMO'S FINAL DECISION**

The IMO's final decision is to accept the proposed amendments to clauses 4.1.1A, 4.5.2, 4.9.3, 4.11.1, 4.12.6, 4.15.1, 4.15.2, Chapter 11 Glossary and Appendix 3, and the addition of clauses 4.28C, 4.28C.1, 4.28C.2, 4.28C.3, 4.28C.4, 4.28C.5, 4.28C.6, 4.28C.7, 4.28C.8, 4.28C.9, 4.28C.10, 4.28C.11, 4.28C.12, 4.28C.13, 4.28C.14, 4.28C.15 of the Market Rules as proposed in the Draft Rule Change Report.

### **9.1 Reasons for the decision**

The IMO has made its decision on the following basis:

- The Amending Rules:
  - will allow the Market Rules to better address Wholesale Market Objective (a) and (b);
  - are consistent with the remaining Wholesale Market Objectives;
  - have the support of the MAC for progression through the Rule Change Process; and
  - have the support of the majority of submissions received during the consultation process.

Additional detail outlining the analysis behind the IMO's reasons is outlined in section 8 of this Final Rule Change Report.

## 10. AMENDING RULES

### 10.1 Commencement

The amendments to the Market Rules resulting from this Rule Change Proposal will commence at **8:00am** on **1 February 2010**.

### 10.2 Amending Rules

The following clauses are amended (~~deleted text~~, added text):

## The Reserve Capacity Cycle

### 4.1. The Reserve Capacity Cycle

4.1.1. This clause 4.1 sets out the timetable by which the key events described in this Chapter in respect of each Reserve Capacity Auction must occur. The events described below comprise a single Reserve Capacity Cycle, except where otherwise indicated. The Reserve Capacity Cycle will be repeated for each Reserve Capacity Auction.

4.1.1A. Clause 4.28B ~~and 4.28C~~ takes precedence over this clause 4.1 and events described in clause 4.28B and 4.28C are not required to comply with the timetable of this section 4.1 except where specified in clause 4.28B and 4.28C.

...

4.5.2. The Long Term PASA Study must take into account:

- (a) demand growth scenarios, including peak and annual energy requirements;
- (b) expected Demand Side Management capabilities and taking into account clause 4.28.10;
- (c) generation capacity expected to be available, including details ~~on~~ of any Early Certified Reserve Capacity, seasonal capacities, Ancillary Service capabilities, long duration outages and, for Non-Scheduled Generators, production profiles;
- (d) expected transmission network capabilities allowing for expansion plans, losses and constraints; and
- (e) the capacity described in clause 4.5.2A.

...

4.9.3. A Market Participant applying for certification of Reserve Capacity must provide to the IMO:

- (a) ~~must provide to the IMO the data specified in clause 4.10.1, in the format specified in the Reserve Capacity Procedure, the data specified in clause 4.10.1;~~

- (b) ~~in addition, must~~, in the case of application for certification of Reserve Capacity for an Intermittent Generator that is yet to enter service, ~~provide to the IMO~~ the report described in clause 4.10.3; and
- (c) in the case of an application for conditional certification for a future Reserve Capacity Cycle, or subsequent applications for Early Certified Reserve Capacity for a Facility for the same Reserve Capacity Cycle, an Application Fee to cover the cost of processing the application.

...

4.11.1. Subject to clause 4.11.7, the IMO must apply the following principles in assigning a quantity of Certified Reserve Capacity to a Facility for the Reserve Capacity Cycle to which the application relates:

...

- (c) the IMO must not assign Certified Reserve Capacity to a Facility for a Reserve Capacity Cycle if:

...

iv. that Facility already has Capacity Credits assigned to it under Clause 4.28C for the Reserve Capacity Cycle.

4.12.6. Subject to clause 4.12.7, any initial Reserve Capacity Obligation Quantity set ...

4.12.6. Subject to clause 4.12.7, any initial Reserve Capacity Obligation Quantity set in accordance with clauses 4.12.4, 4.12.5, ~~or 4.28B.4~~, or 4.28C.4 is to be reduced once the Reserve Capacity Obligations take effect, as follows:

...

4.15.1. If the information provided under clauses 4.14 and 4.28C indicates that no Certified Reserve Capacity is to be made available in the Reserve Capacity Auction for a Reserve Capacity Cycle, or, based on the information received under clause 4.14, the IMO considers that the Reserve Capacity Requirement for the Reserve Capacity Cycle will be met without an auction, then, by the date and time specified in clause 4.1.16, the IMO must publish a notice specifying for that Reserve Capacity Cycle:

- (a) that the Reserve Capacity Auction has been cancelled;
- (b) the Reserve Capacity Requirement;
- (c) the total amount of Certified Reserve Capacity;

(cA) the Capacity Credits assigned under clause 4.28C;

- (d) the total amount of Certified Reserve Capacity that would have been made available in the Reserve Capacity Auction had one been held; and

- (e) the total amount of Certified Reserve Capacity covered by pre-existing Special Price Arrangements;
- 4.15.2. If the Reserve Capacity Auction for a Reserve Capacity Cycle is not cancelled in accordance with clause 4.15.1, then, by the date and time specified in clause 4.1.16, the IMO must publish a notice specifying:
- (a) that the Reserve Capacity Auction will be held;
  - (b) the Reserve Capacity Auction Requirement, where this equals the ~~Reserve Capacity Requirement less the total amount of Certified Reserve Capacity which:~~
    - i. ~~the IMO has notified Market Participants can be traded bilaterally under clause 4.14.9; or Reserve Capacity Requirement; less~~
    - ii. the total amount of Certified Reserve Capacity which the IMO has notified Market Participants can be traded bilaterally under clause 4.14.9 or is covered by a pre-existing Special Price Arrangement; and less
    - iii. the amount of Capacity Credits assigned under clause 4.28C for the relevant Reserve Capacity Cycle; and
  - (c) ...

#### **4.28C. Early Certification of Reserve Capacity**

4.28C.1. This section 4.28C is applicable to Registered Facilities to which the following conditions apply:

- (a) the Facility is a new Facility;
- (b) the Facility is a generating system; and
- (c) the Facility is deemed by the IMO to be committed.

4.28C.2. A Market Participant with a Registered Facility that meets the criteria in 4.28C.1 may apply to the IMO, at any time between the date when the Facility was registered under Chapter 2 and 1 January of Year 1 of the Capacity Cycle to which the application relates, for certification of Capacity and Capacity Credits for that Facility (“**Early Certified Reserve Capacity**”).

4.28C.3. Each application for Early Certified Reserve Capacity must relate to a single future Reserve Capacity Cycle. The IMO must not accept more than one application for certification of Reserve Capacity per Facility per calendar year.

4.28C.4. The application under clause 4.28C.2 must state that the applicant intends to trade all assigned Certified Reserve Capacity bilaterally.

- 4.28C.5. An application made under clause 4.28C.2 must include all the information required by clause 4.10 for the appropriate type of generation system for which the application pertains to.
- 4.28C.6. The IMO must process each application made in accordance with clause 4.28C.2 so as to determine the Early Certified Reserve Capacity, Capacity Credits and Reserve Capacity Obligations in connection with the Facility.
- 4.28C.7. The IMO must, within 90 days of the application, set Early Certified Reserve Capacity for the Facility to that amount it would normally grant the Facility if processing an application for Certified Reserve Capacity in accordance with clause 4.11.
- 4.28C.8. Within 30 Business Days of the applicant receiving notification by the IMO of the amount of Early Certified Reserve Capacity assigned to the Facility the applicant must provided Reserve Capacity Security equal to the amount specified in clause 4.28C.9., else the Early Certified Reserve Capacity assigned to the Facility will lapse.
- 4.28C.9. The amount for the purposes of clause 4.28C.8 and 4.28C.12 is twenty-five percent of the Maximum Reserve Capacity Price included in the most recent Request for Expressions of Interest at the time and date associated with either clause 4.28C.8 or 4.28C.12 as applicable, multiplied by an amount equal to the Early Certified Reserve Capacity assigned to the Facility.
- 4.28C.10. The IMO must set the Capacity Credits for the Facility to equal the Early Certified Reserve Capacity of the Facility once the Reserve Capacity Security is provided to the IMO under clause 4.28C.8.
- 4.28C.11. The IMO must set the Reserve Capacity Obligations, including the initial Reserve Capacity Obligation Quantity, for the Facility in accordance with clause 4.12 as if set as part of an application for Certified Reserve Capacity made in accordance with clause 4.11.
- 4.28C.12. The Reserve Capacity Security provided by the Market Participant under clause 4.28C.4 (b) must, by the time and date in clause 4.1.13 (a), in year 1 of the first Reserve Capacity Cycle in which the Facility will commence operation be recalculated in accordance with 4.28C.9, and the difference paid to the IMO or refunded to the Market Participant as applicable.
- 4.28C.13. If the IMO approves the granting of Capacity Credits to the Facility under this clause 4.28C then the Capacity Credits and the Reserve Capacity Obligations associated with that Facility will apply from the commencement of the Trading Day commencing on the start date until the end of the Trading Day ending on the end date where:
- (a) the start date is 1 October of year 3 of the capacity cycle the application relates to under clause 4.28C.2 ; and
  - (b) the end date is the earlier of:
    - i. the first instance of the date 1 October after the start date; and

ii. \_\_\_\_\_ the decommissioning date of the Facility.

4.28C.14. Capacity Credits issued by the IMO under this clause 4.28C:

(a) are not eligible to be used in a Reserve Capacity Auction; and

(b) are not eligible to have a Long Term Special Price Arrangements or Short Term Special Price Arrangements associated with them.

4.28C.15. The IMO must document the process for applying for and approving Capacity Credits in accordance with this clause 4.28C in the Reserve Capacity Procedure, and the IMO and Market Participants must follow that documented Market Procedure.

## **CHAPTER 11**

**Capacity Credit:** A notional unit of Reserve Capacity provided by a Facility during a Capacity Year. The total number of Capacity Credits provided by a Facility is determined in accordance with clause 4.20, ~~or clause 4.28B,~~ or clause 4.28C. Each Capacity Credit is equivalent to 1MW of Reserve Capacity. The Capacity Credits to be provided by a Facility are held by the Market Participant registered in respect of that Facility. The number of Capacity Credits to be provided by a Facility may be reduced in certain circumstances under the Market Rules, including under clause 4.25.4 or adjusted under clause 4.25.6.

**Early Certified Reserve Capacity:** Reserve Capacity which is certified and assigned to a new Facility by the IMO for a future Reserve Capacity Cycle under clause 4.28C.

**Reserve Capacity Obligations:** For a Market Participant holding Capacity Credits, determined in accordance with clause 4.12.1, ~~or clause 4.28B~~ or clause 4.28C.

**Reserve Capacity Obligation Quantity:** The specific amount of capacity required to be provided in a Trading Interval as part of a Reserve Capacity Obligation set by the IMO in accordance with clauses 4.12.4 and 4.12.5 or clauses 4.28B or 4.28C as adjusted from time to time in accordance with these Market Rules, including under clause 4.12.6.

### **Appendix 3: Reserve Capacity Auction & Trade Methodology**

...

- o For the testing of bilateral trades, for Availability Class  $a = 1$  this is the greater of zero and  $Q[a] - X[a]$  while for Availability Classes  $a = 2, 3$  or  $4$ , this is the greater of zero and  $(Q[a] - X[a] - Y[a-1])$  where

$Q[a]$  is the quantity associated with Availability Class "a" in clause 4.5.12(c).

$X[a]$  is the total quantity of:

- i. \_\_\_\_\_ Certified Reserve Capacity to be provided by Facilities subject to Network Control Service Contracts and by Facilities under Long Term

Special Price Arrangements during the period to which the Reserve Capacity Requirement applies;  
plus  
ii the amount of Capacity Credits assigned under clause 4.28C for the period to which the Reserve Capacity Requirement applies

where the capacity is certified as belonging to Availability Class “a” and is not subject to a bilateral trade.

Y[a] represents the amount by which  $(X[a] + Y[a-1])$  exceeds Q[a], with the exception that  $Y[0] = 0$ .

...

## APPENDIX 1: FULL DETAILS OF THE PROPOSAL

A number of Market Participants and potential developers consider that the current Reserve Capacity Cycle does not adequately accommodate projects that are subject to long lead times. It has been suggested that financiers are unlikely to finance projects based solely on Conditional Certified Reserve Capacity. Conditional Certified Reserve Capacity may be obtained in advance but does not guarantee that Capacity Credits will be subsequently assigned to the Facility. Certainty is only available if the Facility is considered by the IMO to be *under construction*, (a term which is proposed to be changed to *committed* in Rule Change Proposal RC\_2009\_07), when bilateral trade declarations are submitted around 10 August each year.

In its proposal, the IMO considered that there is merit in providing additional security to project developers who can demonstrate commitment to a project beyond the current timeframes. This would facilitate new entry to the market and therefore promote competition.

For new generation Facilities, the IMO proposed to extend the timeframes for Certification of Reserve Capacity and assignment of Capacity Credits. This will allow projects with long lead times to secure Capacity Credits earlier and provide greater certainty for investors. Since longer lead times are mostly relevant for new plant, the IMO proposed that the new timeframe apply only to new generation Facilities. It will not apply to upgrades to generation Facilities or to Demand Side Programmes.

To distinguish this option from the normal certification process in the Rules, the IMO proposed to introduce a new concept of Early Certified Reserve Capacity (ECRC) in conjunction with the current Conditional Certification of Reserve Capacity provisions. ECRC, and subsequently assigned Capacity Credits, will be granted and made available for the applicable Capacity Year and will require no further application to the IMO. Facilities assigned Conditional Certified Capacity will still need to apply for CRC in Year 1.

The IMO proposed that the criteria for being assigned ECRC will be in line with the criteria for being assigned CRC. These criteria are more stringent than for Conditional Certification. In particular, the proposed new criteria and conditions for applying for ECRC are:

- ECRC applications are limited up to 1 January of year 1 of the Reserve Capacity Cycle in which the new Facility will first enter service. From 1 January of year 1 of the Reserve Capacity Cycle for which the application relates, the Facility has to enter the normal certification cycle [outlined in proposed new clause 4.28C.2];
- the Facility must be deemed to be committed by the IMO in order to apply for ECRC [outlined in proposed new clause 4.28C.1 (c)];
- the Market Participant must declare its intention to trade all assigned capacity bilaterally [outlined in proposed new clauses 4.28C.4 and 4.28C.6];
- the Facility must apply each year for ECRC for subsequent Reserve Capacity Cycles and can only apply for one cycle per year [outlined in proposed new clause 4.28C.3];
- subsequent ECRC applications (in case of a failed initial application) for the same Capacity Year will be subject to a processing fee [outlined in clause 4.9.3 (c)];

- the Market Participant must provide Reserve Capacity Security within 30 Business Days of approval of ECRC [outlined in proposed new clause 4.28C.6]; and
- in the interest of maintaining an equivalent basis between Facilities granted ERCR and Facilities granted CRC the security provided at the time of ECRC will be revised in year 1 of the Reserve capacity Cycle to which it relates [outlined in proposed new clause 4.28C.12].

The concept of ECRC was discussed by the MAC at its December 2008 and February 2009 meetings. This Rule Change Proposal is based on the outcomes of MAC's discussions and other consultation with industry representatives. The Reserve Capacity Market Procedure will also be amended to reflect the changes in this proposal if this Rule Change Proposal is accepted.

## APPENDIX 2: THE IMO'S RESPONSE TO ISSUES RAISED DURING THE FIRST SUBMISSION PERIOD

The IMO response to each of the issues raised during the first submission period is as follows:

- LGP questioned whether the drafting of clause 4.28C.1 would achieve the anticipated outcomes as a Facility is unlikely to be committed prior to receipt of certification.

The IMO noted that LGP's suggestion to separate capacity certification from the allocation of Capacity Credits was initially considered prior to presenting the concept of ECRC to the MAC at the 10 December 2008 meeting. However the intent of the Rule Change Proposal is to provide greater certainty to both the market and investors, the IMO considers this alternative approach suggested by LGP would not have the intended outcome. The Rule Change Proposal will provide greater certainty of receiving Capacity Credits to Facilities which are committed with long lead times.

The IMO noted that proposed Facilities only receive Capacity Credits under the current Market Rules where there is a short fall. However, committed Facilities that declare their intention to trade bilaterally are guaranteed Capacity Credits. Therefore moving the timeframe that these Facilities receive Capacity Credits/CRC has no material impact on the level of Capacity Credits that would have been assigned for any Capacity Year.

The IMO also noted that providing ECRC to proposed Facilities would require the introduction of significantly greater complexity into the Reserve Capacity process as outlined in the Market Rules.

- Alinta submitted that there was no evidence provided to support amending the existing Market Rules, and that the proposal lacks certain benefits.

The IMO noted that discussions held with Market Participants and potential developers initially determined that the 28-month reserve capacity cycle does not adequately accommodate projects which are subject to long lead times. It was in response to these discussions that the concept of ECRC has been developed

Additionally, the IMO noted that the further progression of both the concept paper and Rule Change Proposal received the support of the MAC at the February and April 2009 meetings respectively. Likewise, the proposed changes received the support of the majority of submitters during the first submission period.

The IMO noted that by allowing projects with long lead times a surety of income this proposal better enables such projects to become financially viable, removing not only a barrier to entry which is apparent under the current Market Rules but also removing a discriminatory limitation on long lead time projects.

- Alinta submitted that as arranging project finance for a proposed generation project is a necessary precursor to a FID, the proposed ECRC mechanism would not provide potential financiers with any greater certainty as to the assignment of Capacity Credits to the new Facility.

In reply the IMO noted that arranging project finance is not a necessary precursor to a FID and is a process that often occurs in parallel. In particular, an investor can commit to financing without complete project finance, i.e. if they have bought a generator but have not bought all the components and/or building materials. Further details of the factors which will be taken into consideration when assessing whether a project is “under construction” are contained in the Market Procedure for Declaration of Bilateral Trades and the Reserve Capacity Auction Procedure which is available on the IMO website: <http://www.imowa.com.au/market-procedures>

The IMO also noted that the proposed changes will reduce the uncertainty associated with investing in Facilities with long lead times. For example, a coal power station taking four years to build needs to have been undertaking actual construction for two years before conditional certification can be granted. The proposed changes will mean that projects with long lead times would no longer be restricted to waiting to apply for certification two years out.

- Alinta consider ECRC may crowd out new generation from shorter lead time projects and potential additional alternative capacity.

The IMO noted that there would be no difference under the proposed Amending Rules as currently while there is uncertainty about the level of Capacity Credits that may be granted to a Facility it is unlikely that Capacity Credits will not be assigned to a Facility which is “in service” or “committed/under construction” Facility. Alinta noted this point in its submission. The IMO contended that the proposed changes will improve the transparency and certainty for developers making decisions.

- Alinta noted that the proposal does not define a long lead time.

In response the IMO noted that the purpose of the Rule Change Proposal is not to define a long lead time. Anyone who can demonstrate that they are committed to building a Facility can enter into the process and this timeframe can differ considerably between generation projects.

- Alinta considered that the proposal is inconsistent with market objective (c). This is because the ECRC mechanism favours projects with longer lead times which will result in a discrimination against particular energy options and technologies such as gas fuelled generation.

The IMO considered that the proposed changes will remove a current discrimination against longer lead time projects. The IMO noted that the proposed changes will allow for a more equivalent treatment of all new generation projects.

- Alinta considered that the proposal is inconsistent with market objective (a) and (d) in relation to crowding out alternative capacity from upgrades or DSM programmes which may result in inefficient and higher cost capacity entering the market.

In response the IMO noted that the proposed changes would not result in the crowding out of alternative capacity as all Capacity Credit providers, regardless of technology, will

be able to enter the market if they declare an intention to trade bilaterally. Additionally, all committed Facilities will be entitled to receiving Capacity Credits from the date they are committed.

The IMO contended that the proposed changes will improve the transparency and certainty for developers making decisions.

- Alinta considered that the proposal is inconsistent with market objective (b). As arranging project finance for FID and the proposed ECRC mechanism would not provide any greater certainty as to the assignment of Capacity Credits to the new Facility, it is unlikely to facilitate efficient entry of new competitors.

The IMO considered that the proposed changes will make receiving Capacity Credits easier once a Facility is committed. The IMO reiterated that arranging project finance is not a requirement for receiving FID and often occurs in parallel. ECRC will mean that new entrant generators will be able to enter the market with a reduced level of financial risk.