Wholesale Electricity Market
Rule Change Proposal Submission Form

RC_2009_10 Early Certified Reserve Capacity

Submitted by

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Submission

1. Please provide your views on the proposal, including any objections or suggested revisions.

Background

Under the current Reserve Capacity Cycle, Capacity Credits are assigned to new Facilities around 10 August each year, 24 to 28 months ahead of the date when capacity from the new Facility would be expected to be available to the market.

The IMO claims that a number of Market Participants and potential developers of new Facilities have put the view that the current Reserve Capacity Cycle does not adequately accommodate generation projects that have 'long' lead times.

The IMO also indicates that it has been suggested that financiers are unlikely to finance generation projects based solely on Conditional Certified Reserve Capacity.

The IMO argues that there is merit in providing additional security to project developers who can demonstrate commitment to a project beyond the current Reserve Capacity Cycle timeframes, as this would facilitate new entry and therefore promote competition.

Rule Change Proposal

RC_2009_10 would establish a new concept of Early Certified Reserve Capacity (ECRC), which would essentially assign Capacity Credits to a (committed) Facility outside of the current Reserve Capacity Cycle, and would not require a subsequent application to the IMO for Certified Reserve Capacity as part of a future Reserve Capacity Cycle.

Alinta's views

Alinta 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.[1]

Firstly, 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. 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.

Second, 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 noted that under RC_2009_10, the assignment of Capacity Credits through the ECRC mechanism would remain contingent on the Facility being deemed to be 'committed' by the IMO, which it argued implied a FID had been made and hence project finance would also already have been arranged.

The IMO suggested that arranging project finance is not a necessary precursor to a FID, but often occurs in parallel. In particular, it argued that an investor could commit to financing without complete project finance, for example a generator may have been bought but not all the components and/or building materials. Alinta is not able to comment on this claim, but notes that 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.

The following additional comments/observations are offered on the IMO's draft Rule Change Report.

Impact on project risk

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

[1] Detailed reasons for Alinta's position are outlined in its first submission to the IMO (dated 9 June 2009).

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*" (emphasis added).

Hence under the existing Market Rules, there would **not** appear to be any risk that a **committed** project **will not** receive Capacity Credit.[2]

As a result, 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

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

Potential alternative approach

Alinta suggests that instead of the amendments proposed by RC_2009_10, consideration could be given to 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'.

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;
- would 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.

Alinta considers such an approach 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 intended consequences that could potentially arise from establishing ECRC as a new concept in the Market Rules as envisaged by RC_2009_10.

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2 As previously noted, Conditional Certified Reserve Capacity may be sought at any time to provide certainty with respect to the <u>level</u> of capacity credits that would be assigned to a proposed Facility.

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2. Please provide an assessment whether the change will better facilitate the achievement of the Market Objectives.

Market Rule 2.4.2 states 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. The Wholesale Market Objectives are 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.

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

(c) To avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions.

(d) To minimise the long-term cost of electricity supplied to customers from the South West interconnected system.

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

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 again 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.

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.

3. Please indicate if the proposed change will have any implications for your organisation (for example changes to your IT or business systems) and any costs involved in implementing these changes.

The changes to the Market Rules contemplated by RC_2009_10 would not require Alinta to change its IT or business systems, and hence there are no IT or business costs associated with the rule change proposal.

4. Please indicate the time required for your organisation to implement the change, should it be accepted as proposed.

The changes to the Market Rules contemplated by RC_2009_10 would not require Alinta to change its IT or business systems, and hence there is no specific period of time that would be required to implement the changes arising from the rule change proposal.