



INDEPENDENT  
MARKET  
OPERATOR

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## Procedure Change Report

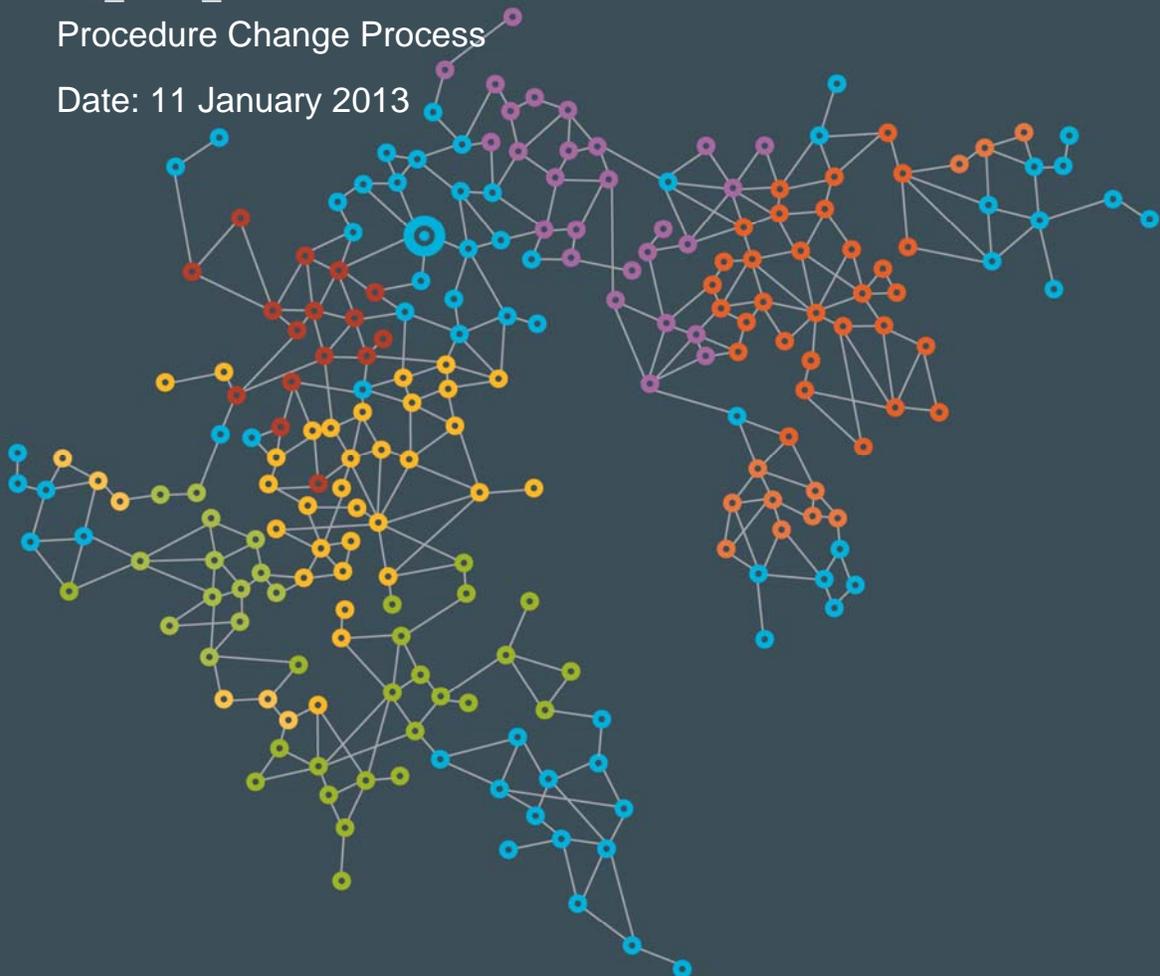
Title: Changes to Market Procedure for  
Determination of the Maximum Reserve  
Capacity Price

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PC\_2012\_08

Procedure Change Process

Date: 11 January 2013



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## Executive Summary

### ***Proposed amendments***

The Market Procedure for determination of the Maximum Reserve Capacity Price (Procedure) describes the methodology that the IMO must use and the steps that the IMO must undertake in determining the Maximum Reserve Capacity Price (MRCP) in each Reserve Capacity Cycle. The IMO proposed a number of amendments to the Market Procedure to ensure consistency with the Amending Rules resulting from the Rule Change Proposal: Competitive Balancing and Load Following Market (RC\_2011\_10). The IMO also proposed to amend the Franking credit value in the Weighted Average Cost of Capital (WACC) in order to align it with the value regularly applied by other relevant Australian regulatory bodies.

### ***Consultation***

- The IMO proposed a number of amendments to the Market Procedure. The majority of these amendments were discussed by the IMO Procedure Change and Development Working Group at the 14 August 2012 meeting.
- In addition, the IMO proposed to amend the value of Gamma that is used in the calculation of the WACC. This change was discussed at a stakeholder workshop on 1 November 2012.
- The IMO formally submitted the Procedure Change Proposal and issued a notice calling for submissions on 12 November 2012.
- The submission period was held between 13 November 2012 and 10 December 2012. The IMO received submissions from Alinta Energy, Community Electricity and Verve Energy.

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

The IMO considers that the amended Market Procedure, as a whole, is consistent with the Wholesale Market Objectives.

### ***The IMO's Decision***

The IMO's decision is to accept the Procedure Change Proposal as modified following the consultation period.

### ***Next steps***

The amended Market Procedure for Determination of the Maximum Reserve Capacity Price will commence at **8.00am** on **15 January 2013**.

## 1. Procedure Change Process and Timetable

On 12 November 2012 the IMO submitted a Procedure Change Proposal regarding amendments to (PC\_2012\_08). This proposal has been processed using the Procedure Change Process, described under clause 2.10 of the Market Rules.

The key dates in processing this Rule Change Proposal are:



## 2. Proposed new Market Procedure

### 2.1. The Procedure Change Proposal

This Procedure describes the methodology that the IMO must use and the steps that the IMO must undertake in determining the Maximum Reserve Capacity Price in each Reserve Capacity Cycle.

The IMO proposed to update the Procedure to ensure consistency with the Amending Rules resulting from the Rule Change Proposal: Competitive Balancing and Load Following markets (RC\_2011\_10). In particular the IMO proposed to update the definition of Power Station upon which the Maximum Reserve Capacity Price is based to include the minimum level of equipment or systems required to satisfy Balancing Facility Requirements (step 2.1.1). In addition the IMO proposed the following minor changes.

- update the list of Market Procedures associated with this Procedure under section 1.4; and
- clarification of Terminologies and Definitions (step 1.6.1).

The IMO also proposed to amend the Franking credit value of 0.5 in the WACC to 0.25 in order to align it with the value regularly applied by other Australian regulatory bodies. Following a decision by the Australian Competition Tribunal in May 2011, both the Australian Energy Regulator (AER) and Economic Regulatory Authority (ERA) have regularly applied a value of 0.25 in regulatory decisions.

To improve the integrity of the Market Procedure, the IMO also proposed a small number of minor and typographical amendments.

For full details of the Procedure Change Proposal please refer to the Market Web Site: [http://www.imowa.com.au/PC\\_2012\\_08](http://www.imowa.com.au/PC_2012_08)

## 3. Consultation

### 3.1. Market Advisory Committee or Working Group

The Market Advisory Committee (MAC) has given delegation to the IMO Procedure Change and Development Working Group (IMOPWG) (clause 2.3.17(a)) to consider IMO Procedure Change Proposals.

The amendments to the Market Procedure that were required to ensure consistency with the Amending Rules resulting from the Rule Change Proposal: Competitive Balancing and Load Following Market (RC\_2011\_10) were discussed by the IMOPWG at its 14 August meeting. No further discussion ensued. The full details of the proceedings of the IMOPWG can be found on the IMO Market Web Site: <http://www.imowa.com.au/IMO-Procedures-Working-Group>.

The IMO conducted a public workshop and invited members of the Market Advisory Committee (MAC) and former members of the Maximum Reserve Capacity Price Working Group (MRCPWG) to discuss the proposed change to the Franking credit value as outlined in section 3.2.

In accordance with clauses 2.10.8 and 2.10.9 on 12 November 2012 the IMO notified the MAC once the Procedure Change Proposal had been published and noted that it would convene a meeting of the MAC should two or more members request it. No MAC member contacted the IMO in this regard.

### 3.2. Public Workshop

The IMO invited members of the Market Advisory Committee (MAC) and former members of the Maximum Reserve Capacity Price Working Group (MRCPWG) to a stakeholder workshop on 1 November 2012 to discuss the proposed change to the Franking credit value. At this workshop broad agreement was reached to progress this amendment in a Procedure Change Proposal. The IMO received advice in relation to this change from PricewaterhouseCoopers, which was published in the Procedure Change Proposal.

### 3.3. Submissions received during consultation period

The public consultation period for the proposed amended Market Procedure was between 13 November and 10 December 2012. The IMO received submissions from Alinta Energy, Community Electricity and Verve Energy during the consultation period.

#### Alinta Energy

Alinta Energy supported the IMO's proposed amendments to the Market Procedure. In particular, Alinta supported the revised Gamma value of 0.25.

Alinta Energy identified a number of minor and typographical errors in the version of the Market Procedure that was published for consultation which have been corrected in the final version of the Market Procedure. In addition, Alinta suggested the following amendment:

- Page 15 – Given the comments by the IMO that the ERA's "Bond-Yield Approach" is considered to be acceptable regulatory practice the footnote on this page may no longer be necessary. The IMO should also review the Market Procedure to assess whether any further changes are required to reflect the adoption of the ERA's approach. Alinta Energy's

specific views on the adoption of the ERA's approach will be provided separately in its submission on the MRCP for the 2015/16 Capacity Year.

Additionally, Alinta Energy suggested that it would have been useful to publish a tracked change version of the proposed amended Market Procedure.

Alinta Energy also noted its concern over the continued application of the prescribed values for the equity beta and market risk premium when determining the WACC. Alinta Energy noted that these concerns will be provided separately by Alinta Energy in its submission on the MRCP for the 2015/16 Capacity Year given that these concerns are not within the scope of the PC\_2012\_08.

### Community Electricity

Community Electricity supported the Procedure Change Proposal on the grounds that it updated calculation of the WACC reflects current regulatory practice with respect to the Franking credit 'Gamma,' which would otherwise be reviewed on a 5-yearly basis.

Community Electricity suggested that the footnote on page 15 of 18 should be updated (or removed) as the situation has moved on from the stated situation and retention of the footnote in its current form inappropriately creates uncertainty.

### Verve Energy

Verve Energy submission made the following observations:

Step 2.9.7(h) of the Market Procedure requires that:

*"The IMO must determine the methodology to estimate the DRP, which in the opinion of the IMO is consistent with current Australian accepted regulatory practice."*

This statement is supplemented by the following foot note:

*"Given observed issues with Bloomberg data, the ERA adopted an alternative 'Bond-Yield Approach' to establishing the DRP in its Final Decision on revisions proposed by WA Gas Networks (WAGN) to the access arrangement for the Mid West and South West gas distribution systems. It is understood that WAGN is appealing the use of this method to the Australian Competition Tribunal. Pending the outcome of the appeal, and if the 'Bond-Yield Approach' were to become accepted Australian regulatory practice, the IMO intends to amend this Market Procedure."*

Verve Energy notes that in June 2012 the Australian Competition Tribunal broadly upheld the 'Bond-Yield Approach' methodology. As such, Verve Energy considers that the Market Procedure should be amended to reflect this.

- Step 1.2.2 of the Market Procedure notes that references to the Wholesale Electricity Market Rules (Market Rules) are current as of 1 September 2012, Verve Energy considers this could be updated to refer to the most recent version of Market Rules (1 November 2012).
- Step 1.3.1 of the Market Procedure refers to the parties that the procedure applies to. At the 27 November 2012 IMOPWG, the IMO noted that it had recently adopted a new standard step 1.3.11, whereby reference is made to clauses 2.9.6, 2.9.7 and 2.9.8 of the

Market Rules as opposed to listing the specific entities/Rule Participant class which the procedure applies to. Verve Energy suggests that the IMO update this clause to follow this convention.

- New step 2.1.1(g) contains a superfluous open bracket.

#### Cost and implementation issues

Alinta Energy did not comment on the cost and time required to implement the amendments.

Community Electricity noted that the proposed amendments to the Procedure would not have any cost implications for them and did not identify any actions that would be required to implement the amendments.

Verve Energy noted that they would not incur any costs as a result of the amendments (either as proposed by the IMO or amended as suggested by Verve) and did not identify any actions that would be required to implement the amendments.

#### Assessment against the wholesale Market Objectives

The assessment by submitting parties as to whether the proposal would better achieve the Wholesale Market Objectives is summarized below:

Submitter	Wholesale Market Objective Assessment
Alinta Energy	No comment
Community Electricity	The procedure change is consistent with the Wholesale Market Objectives
Verve Energy	Not applicable

The full text of the submissions by Alinta Energy, Community Electricity and Verve Energy are available on the IMO website: [http://www.imowa.com.au/PC\\_2012\\_08](http://www.imowa.com.au/PC_2012_08).

## 4. The IMO's assessment

In determining whether to accept the Procedure Change Proposal, the IMO has undertaken an assessment in light of clauses 2.9.3 (a) of the Market Rules. Market Procedures must be:

- developed, amended or replaced in accordance with the process in the Market Rules;
- consistent with the Wholesale Market Objectives; and
- consistent with the Market Rules, the Electricity Industry Act and Regulations.

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

### 4.1. Further changes to the Market Procedure

The IMO notes that this Procedure Change Proposal was developed following extensive analysis and review, including both informal and formal consultation.

Following the public consultation process for PC\_2012\_08 the IMO has determined to incorporate some additional changes to the Market Procedure. These include:

- amendments to the footnote on page 15 of 18 to note that the “Bond Yield Approach” methodology was broadly upheld on appeal to the Australian Competition Tribunal and to also note the IMO’s intent to amend this Market Procedure in the near future to implement “Bond Yield Approach” methodology;
- amendments to the Step 1.2.2 to note that references to the Market Rules within the procedure are current as of 1 November 2012;
- amendments to Step 1.3.1 to make reference to clauses 2.9.6, 2.9.7 and 2.9.8 of the Market Rules; and
- amendments to a number of minor and typographical errors.

#### **4.2. Wholesale Market Objectives**

The IMO considers that the Market Procedure, as a whole, if amended will be consistent with the Wholesale Market Objectives. Further, the IMO considers that the steps of the Market Procedure, if amended, are drafted in such a way that the amended Market Procedure would better address Wholesale Market Objective (a). The proposed change to the Franking credit value will ensure that the WACC more accurately reflects the cost of capital to the market.

#### **4.3. Wholesale Market Rules, the Electricity Industry Act and Regulations**

The IMO considers that the proposed amended Market Procedure is consistent, as a whole, with the Market Rules, the Electricity Industry Act and Regulations. The IMO also considers that the Market Procedure is consistent with all other Market Procedures.

#### **4.4. Implementation of the Market Procedure**

The proposed amendments to the Market Procedure will not require the IMO, System Management or Market Participants to implement any procedural or system amendments before it can commence.

The IMO considers that commencement at **8:00 AM** on **15 January 2013** will allow Rule Participants sufficient time from the date of publication of this Procedure Change Report to ensure compliance with the amended Market Procedure.

### **5. The IMO’s decision**

The IMO’s decision is to approve the amended Market Procedure for determination of the Maximum Reserve Capacity Price as proposed in the Procedure Change Proposal.

The IMO has made its decision on the basis that the proposed amendments:

- are consistent with the Wholesale Market Objectives;
- are consistent with the Market Rules, Electricity Industry Act and Regulations; and
- require no procedural or system amendments prior to implementation.

## **6. The Amended Market Procedure**

### **6.1. Commencement**

The amended Market Procedure for determination of the Maximum Reserve Capacity Price will commence at 8.00 AM on 15 January 2013.

### **6.2. The Amended Market Procedure**

The amended Market Procedure for determination of the Maximum Reserve Capacity Price is attached to this report and is also available on the IMO's website: <http://www.imowa.com.au/market-procedures>