CAPACITY COST PRUDENTIAL IMPACTS – RULE CHANGE PROPOSAL

PARTICIPANT WORKSHOP

3 March 2017

PRESENTED BY
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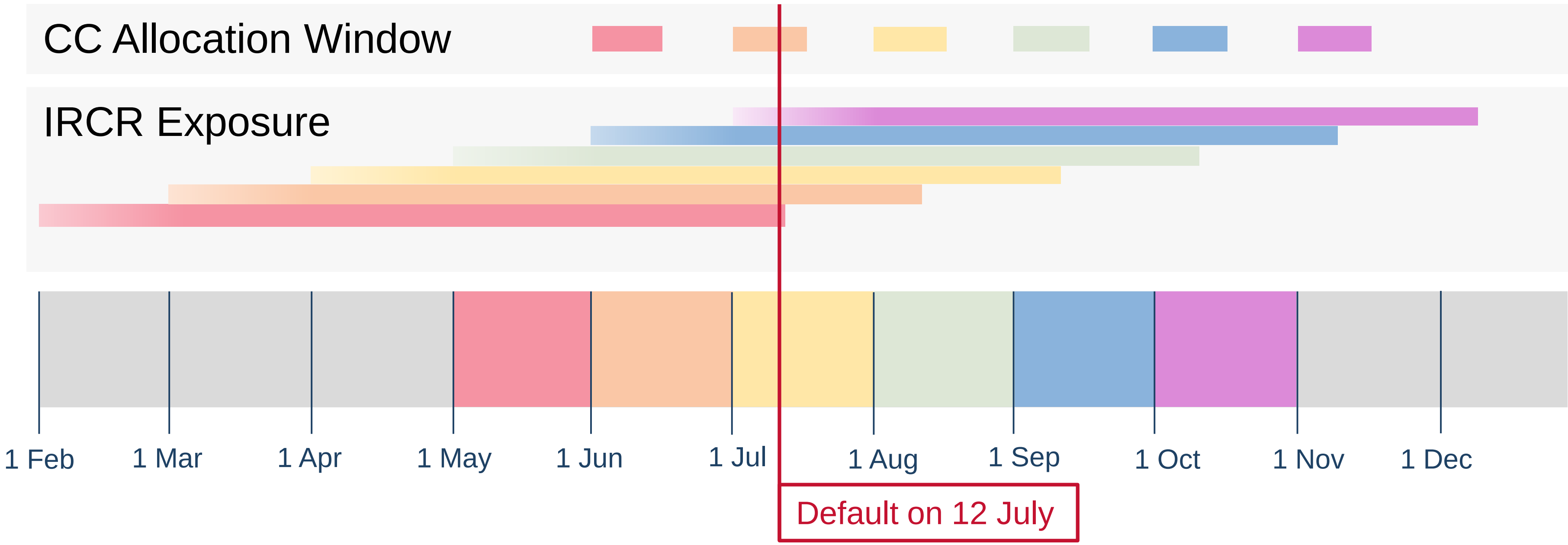
AGENDA

1. Outline of current methodology
2. Exercise – Estimated shortfall and default levies
3. Proposed rule change
4. Exercise – Proposed rule change

PROSPECTIVE CAPACITY LIABILITIES

- Ownership in month n-3 impacts IRCR in month n which is invoiced in month n+2.
- Capacity Credit allocations can only be made after the completion of the trading month.



- Consider a Market Customer's liabilities as at 12 July:
  - They are liable for IRCR for May, Jun, Jul, Aug, Sep and 12/31 of Oct
  - If they traded bilaterally their counter-party:
    - may not have entered any capacity credit allocations with AEMO for Jun; and
    - could not have entered any capacity credit allocations for Jul, Aug, Sep and Oct.
  - Market Generators may not make Capacity Credit Allocations in the event of a Market Customer default.

EXERCISE
(TO BE PROVIDED AT WORKSHOP)

- AEMO will walk through an example which quantifies the impact of the issue identified by exploring:
  - Current Outstanding Amount methodology;
  - Default and Suspension Processes;
  - Expected Prudential Shortfall; and
  - Impact to Market Participants through Default Levies.

RULE CHANGE PROPOSAL

- In April 2017, AEMO intends to submit a Rule Change Proposal that:
  - mitigates the capacity cost prudential risk in a timely manner;
  - minimises increase to prudentials;
  - minimises change to existing rules, systems and processes; and
  - is consistent with the market objectives and market reform.

- AEMO expects the Rule Change Panel will consider the Rule Change Proposal through the consultation process.

- The timing of the implementation of any changes is a matter for the Rule Change Panel. AEMO proposes to implement as soon as possible noting the current constraints (e.g. RCM changes).

ADDRESSING THE ISSUE
SUMMARY

- There are two aspects to any Rule Change Proposal:

1. Reducing participant exposure, and therefore reducing prudential impact; **and**

2. Developing a better estimate of participants’ prudential exposure.

ADDRESSING THE ISSUE
REDUCING EXPOSURE

- There are a number of options to reduce the exposure incurred through the capacity cost rules:

Reduce n-3 ownership lag Capacity Credit Allocations submitted before month n	• Mitigates the capacity cost prudential risk in a timely manner. • Minimises increase to prudentials. • Consistent with the market objectives and market reform. • Minimal change to existing rules and systems.
Review of settlement timelines (e.g. weekly settlement) Daily IRCR with monetary reallocations (instead of CC Allocations)	• Will not mitigate the capacity cost prudential risk in a timely manner. • Minimises increase to prudentials. • Consistent with market objectives and market reform. • Significant change to existing rules and systems.

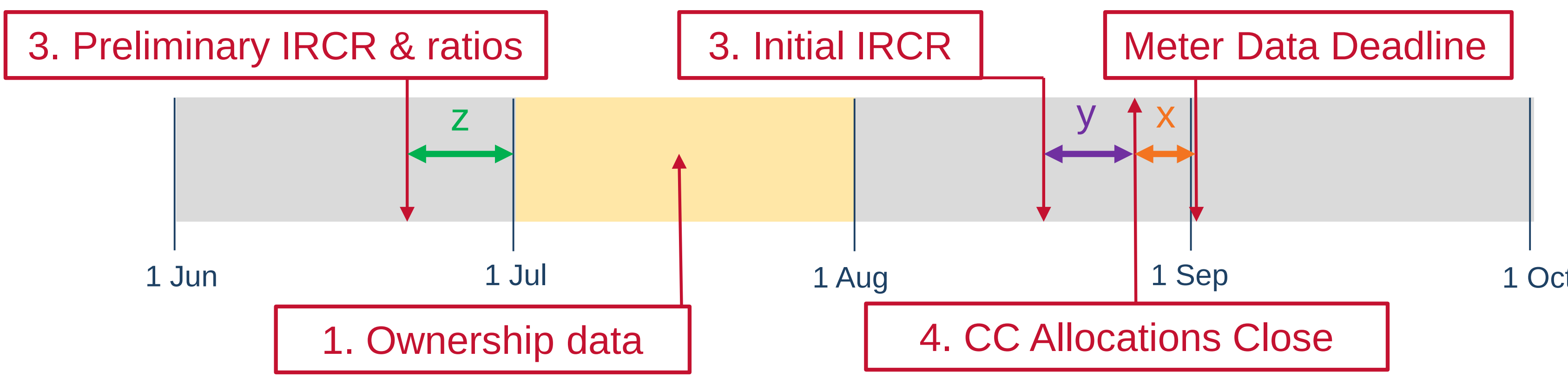
ADDRESSING THE ISSUE
ACCURATELY REPRESENTING EXPOSURE

- There are a number of options to accurately represent participants’ exposure:

Improve Outstanding Amount calculation to better estimate exposure in real time.	• Mitigates the capacity cost prudential risk in a timely manner. • Minor changes to systems and processes. No change to rules. Managed through procedure change. • Prudential exposure is managed via Credit Support and prepayments.
Change to Credit Limit determination methodology	• May result in significant increases to Credit Support. • May not mitigate the capacity cost prudential risk in a timely manner.

PROPOSED CHANGE
SUMMARY

#	Item	Current Rules	Proposed Change
1	**Ownership Data**	n-3	n
2	**Settlement Adjustments**	IRCR is not adjusted.	IRCR recalculated according to normal adjustment cycle.
3	**IRCR Publication**	n-1	Preliminary **z business days** before month n. Initial **y business days** before CC Allocations close.
4	**Capacity Credit Allocations**	Start of n+1	Open window when capacity credits are assigned. Close window **x business days** before meter data deadline. Require binding handshake.
5	**Capacity Credit Over-Allocations**	Allocations reduced to zero.	Reduce over-allocations to IRCR.
6	**Outstanding Amount Calculation**	Linear projection based on historic invoice amounts.	Outstanding Amount is better estimate of individual settlement components. (including IRCR, CC allocations & energy charges).



PROPOSED CHANGE
1 – OWNERSHIP DATA

- Change: Change target month from n-3 to n, for meter ownership only.

- Purpose: To reduce exposure from 160 days to 70 days, reducing overall market risk.

- Implications:
  - The accuracy of meter ownership data will be impacted (caused by churn, new NMIs, etc).
    Therefore the recalculation of IRCR in settlement adjustments is proposed.
  - The publication time of IRCR needs to change.

PROPOSED CHANGE
2 – ADJUSTMENTS

- Change: Recalculate IRCR and Ratios as part of settlement adjustments.

- Purpose: To compensate for the reduced accuracy of meter ownership data in the IRCR calculation. IRCR adjustments will be driven by changes to meter data, which is consistent with energy adjustments.

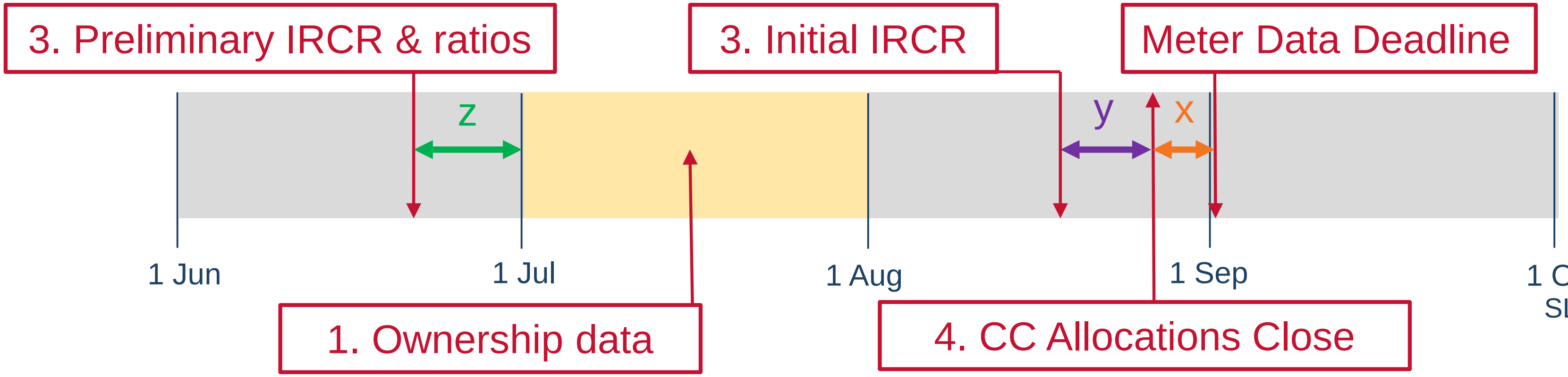
- Implications:
  - Must consider what parameters can change at each adjustment.
  - CC over-allocations must be considered at each adjustment.

- Proposed Decisions/Outcomes:
  - The 12 and 4 peak intervals will not change between initial settlement and adjustments. All other inputs (meter ownership, meter data) may change in adjustments. This is aligned with energy settlement.

- Question: When should the 12 and 4 peak intervals be fixed?

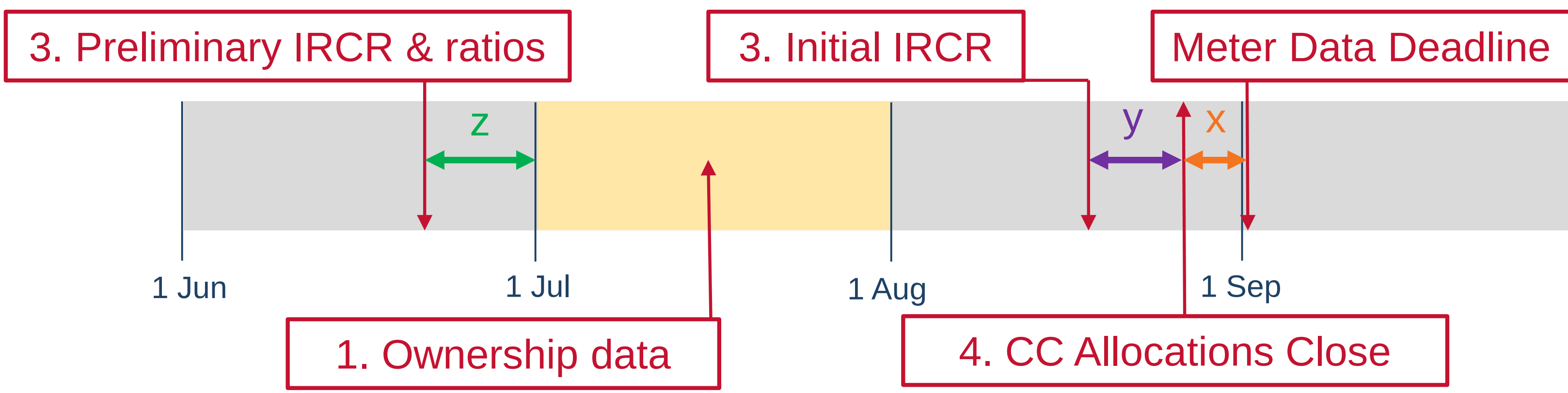
PROPOSED CHANGE
3 – IRCR PUBLICATION

- Change: Publish IRCR in month n+1 for initial settlement.
- Purpose: The current publication of IRCR, 5 business days prior to month n, would not pick up any changes in meter ownership for month n.
- Implications:
  - o Market Customers would no longer know IRCR or ratios prior to the IRCR month. This may impact Market Customers billing processes. Therefore a preliminary IRCR has been proposed. Changes to the preliminary IRCR are mainly driven by churn.
- Question: Based on billing processes, when is the best time for the IRCR to be published for initial settlement? (i.e. What is the best value for **x** and **y** below?) (Later publishing increases accuracy, but provides less time for Capacity Credit Allocations to be submitted after publication.)



PROPOSED CHANGE
3 – PRELIMINARY IRCR

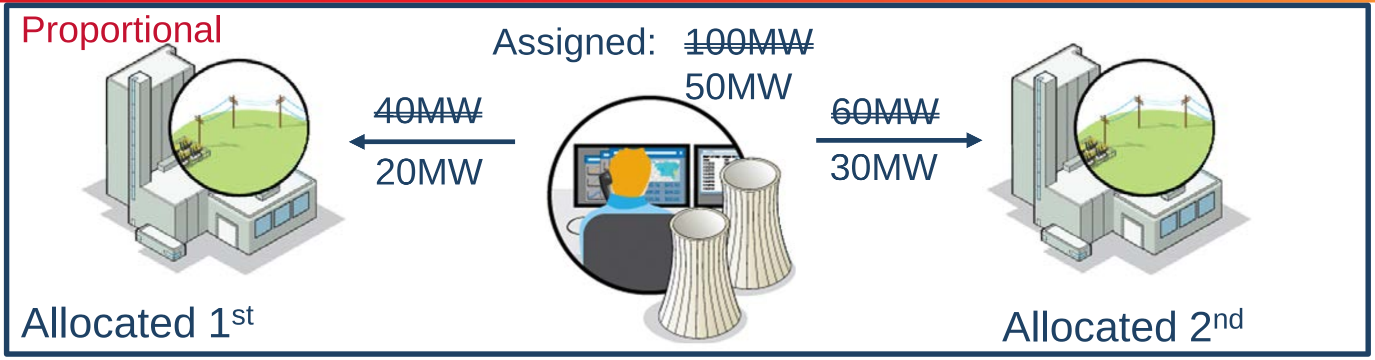
- Change: Provide a preliminary IRCR publication
- Purpose: To provide Market Customers with an indication of their IRCR contribution, TDL and NTDL ratios prior to the IRCR month to assist their billing processes and guide them with CC allocations.
- Implications:
  - o Preliminary IRCR is for information only and will change.
- Question: When would Market Customers recommend AEMO publish the preliminary IRCR and ratios? (i.e. what is the best value for **z** below?)

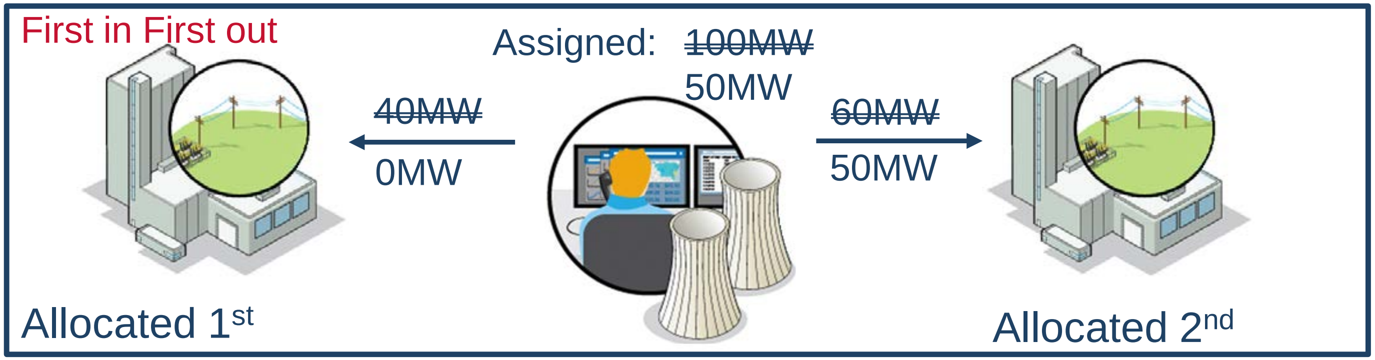


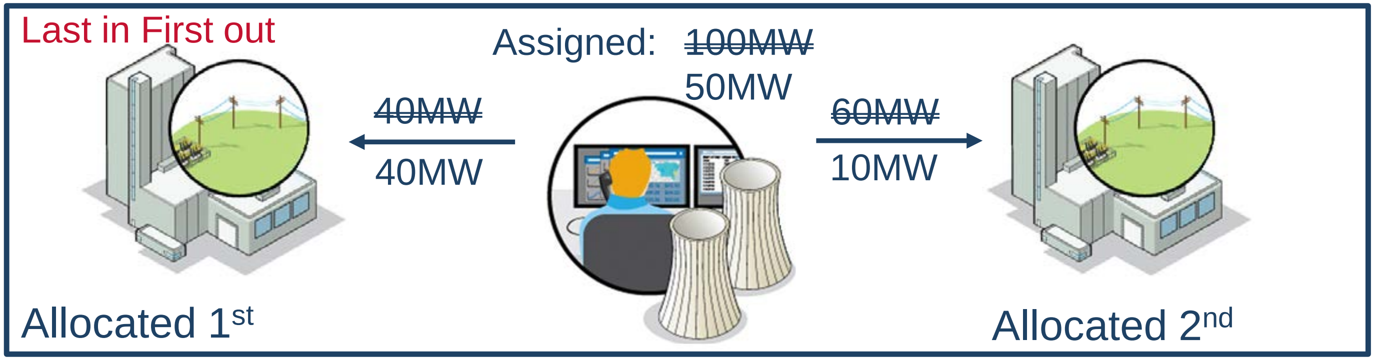
PROPOSED CHANGE
4 – CAPACITY CREDIT ALLOCATIONS

- Change:
  - Open CC allocation window when CC are assigned for that capacity year.
  - Require a “handshake” agreement between Market Participants.
  - Commitment can only be reversed by AEMO. (e.g. error correction, on request by Market Participants, suspension event). AEMO must consider prudential implications.
- Purpose:
  - To allow Market Participants to manage their Outstanding Amount by entering capacity credit allocations prior to incurring the exposure.
  - To ensure both parties accept the allocation, after which it will be binding.
- Implications:
  - Over-allocations must be considered as CC Allocations may be submitted prior to the IRCR calculation.
  - Capacity Credits may be reduced after Allocations have been made.
- Proposed Decisions/Outcomes:
  - If a Market Generator’s CC are reduced, resulting in them having allocated more than the hold they will be given the opportunity to reduce their allocations within a specified time period. The rules will detail any reductions to CC Allocations after this time. (see next slide for options)
- Question: What impact will this cause to existing contracts?

PROPOSED CHANGE
4 – CAPACITY CREDIT ALLOCATIONS







- Question: What option do participants prefer?

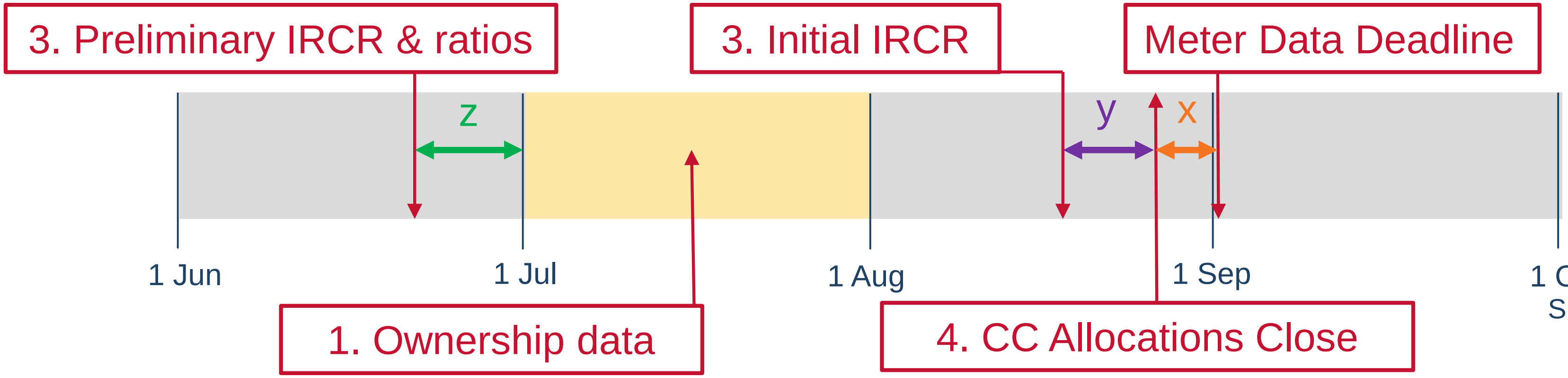
PROPOSED CHANGE

5 – OVER-ALLOCATIONS IN INITIAL SETTLEMENT

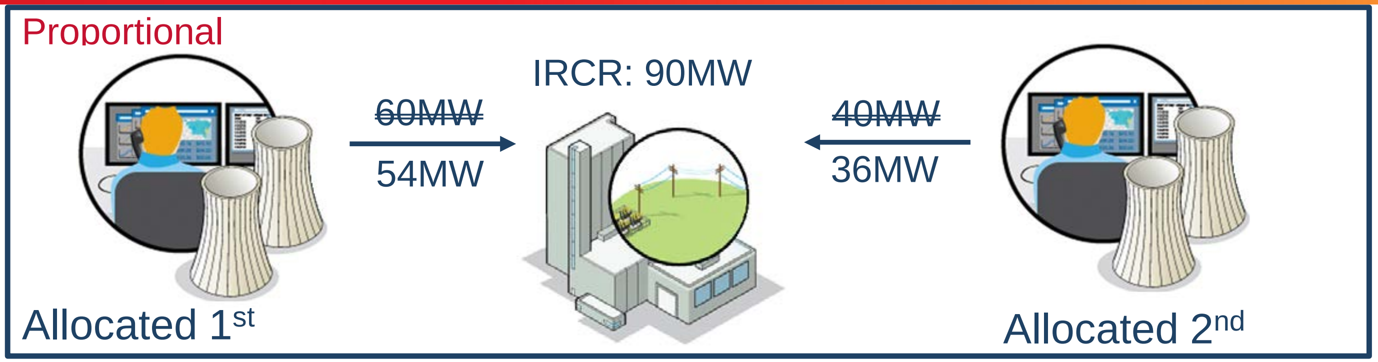
- Changes: Market Customers will have **x** business days after the capacity credit allocation window closes to reduce any over-allocations to their IRCR. After this the rules will prescribe how to reduce capacity credit allocations to the IRCR, if it was not voluntarily reduced prior. (see options on the next slide)
  Currently, CC Allocations are reduced to zero if they are not reduced voluntarily.

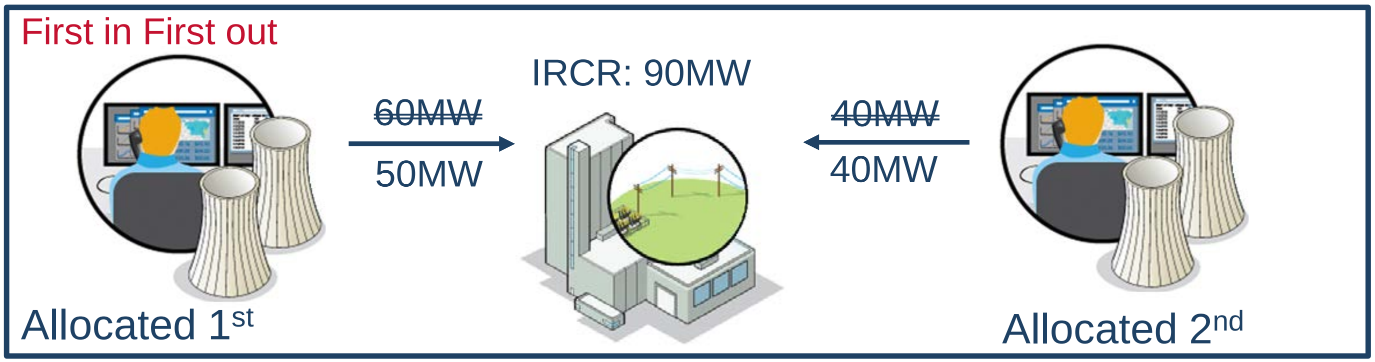
- Purpose: To manage CC over-allocations whilst minimising prudential impacts.

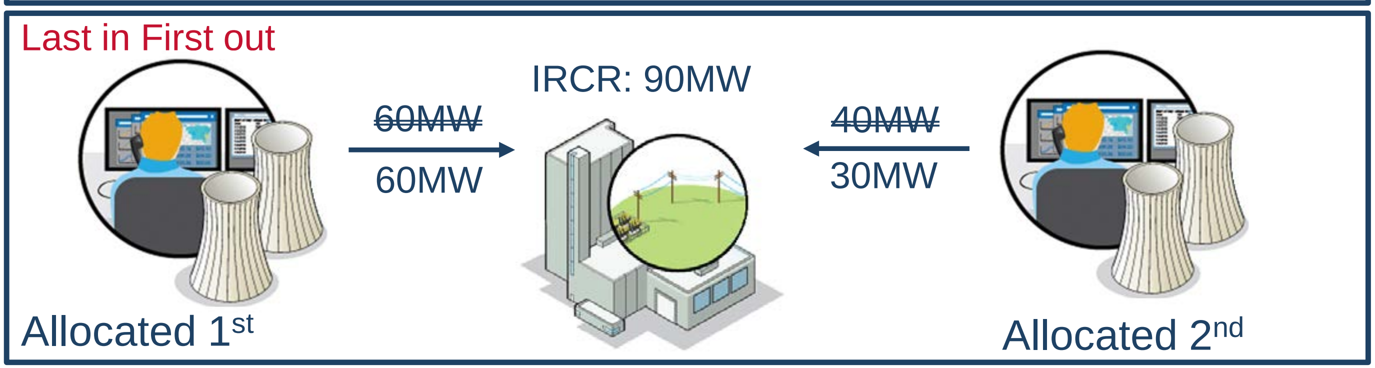
- Question: What is the best number of business days for Market Customers to voluntarily reduce over-allocations? (i.e. what is the best value for **x**?)



PROPOSED CHANGE
5 – OVER-ALLOCATIONS IN INITIAL SETTLEMENT







- Question: What option do participants prefer?

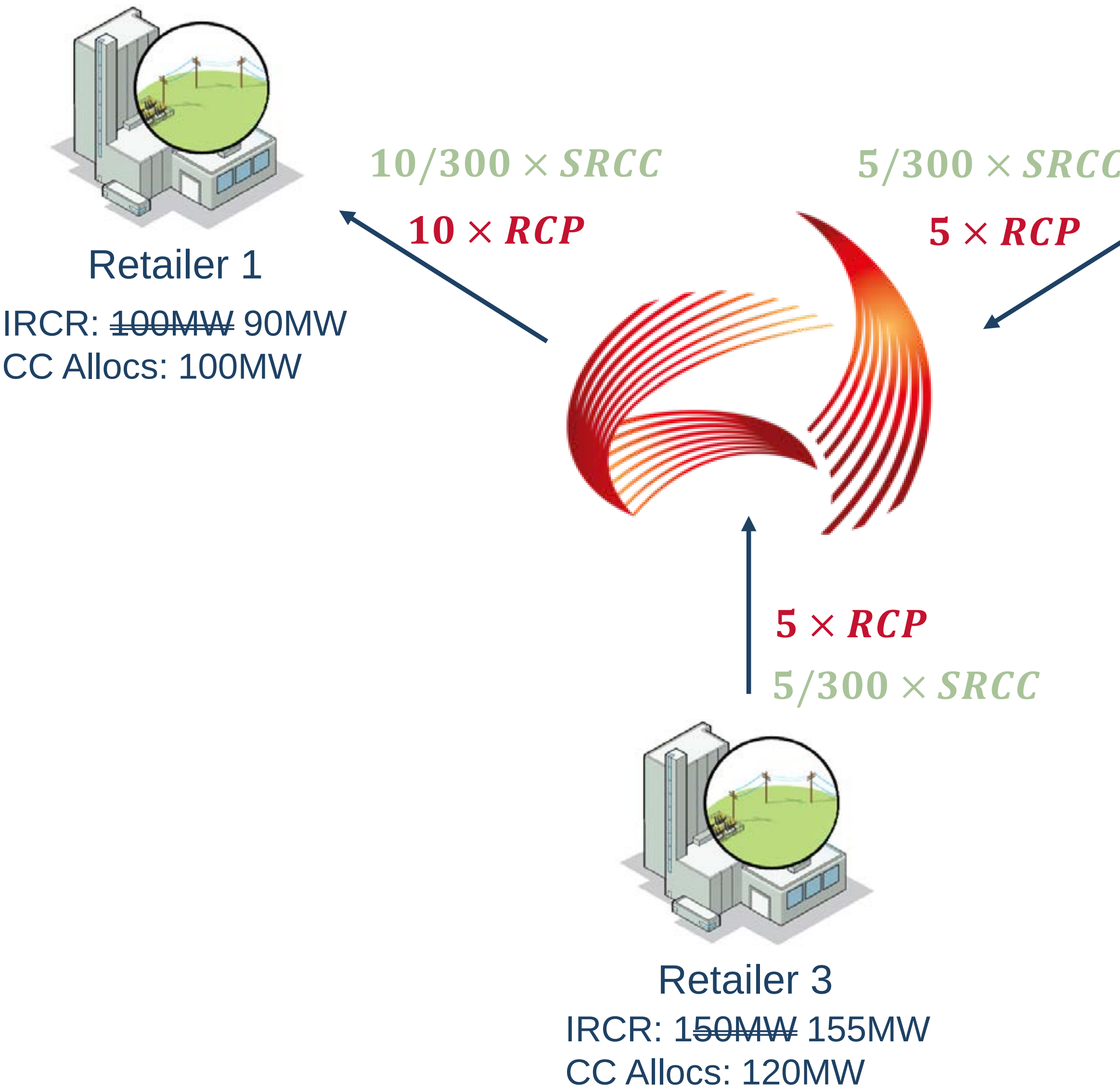
PROPOSED CHANGE

5 – OVER-ALLOCATIONS IN ADJUSTMENT SETTLEMENT

- Changes: Settle over-allocations at the Reserve Capacity Price. This will have no impact on Market Generators.

- Purpose: To manage CC over-allocations whilst minimising prudential impacts.

PROPOSED CHANGE
5 – OVER-ALLOCATIONS IN ADJUSTMENT SETTLEMENT



Relates to Targeted Reserve Capacity Cost (TRCC) assuming no Supplementary Capacity Credits

Relates to Shared Reserve Capacity Cost (SRCC)

PROPOSED CHANGE
6 – OUTSTANDING AMOUNT CALCULATION

- Change: Revise the Outstanding Amount calculation methodology in the Market Procedures (no rule change required) to:
  - use latest IRCR value and agreed CC Allocations;
  - consider better estimates for **all** components of Outstanding Amount (not just capacity costs); and
  - update the Outstanding Amount calculation on a daily basis.

- Purpose: To better estimate Outstanding Amount and manage prudential risk.

- Implications:
  - Allows Market Participants to manage their Outstanding Amount with CC Allocations.

- Note: This point does not require a rule change and can be managed through a procedure change. AEMO proposes to consult on Market Procedure changes to the Outstanding Amount calculation.

PROPOSED CHANGE
7 – DISCUSSION ON TRANSITIONAL MEASURES

- Summary:
  - Assume the rule changes occurs on 1 October.
  - In September the IRCR will be calculated based on ownership in June.
  - In October the IRCR will be calculated based on ownership in October.

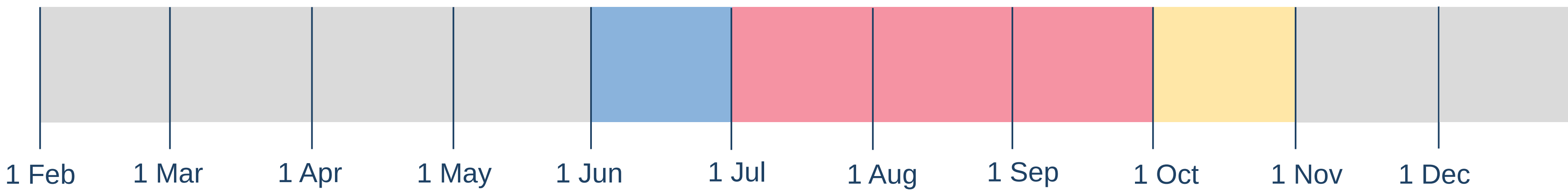
- Implication:
  - Consideration must be given to NMI ownership during the months of July, August and September.
  - Consideration must be given to the timing of the last IRCR calculation under the current rules.

- Possible Options (See example):
  - Have no transitional measure – July, August and September are just ignored.
  - For the month of October base the ownership of each NMI as a % of the 4 month period July – October.
  - Other options?

- Question: What transitional measures do participants prefer?

PROPOSED CHANGE
7 - TRANSITIONAL MEASURES

- The timeline below shows which retailer owned the NMI in June to August.



- In September, Retailer Blue will be charged IRCR.
- In October, with no transitional measure, Retailer Yellow will be charged all of the IRCR and Retailer Red will be charged nothing.
- In October, with a transitional measure, Retailer Red will be charged ¾ of the IRCR and Retailer Yellow will be charged ¼ of the IRCR.

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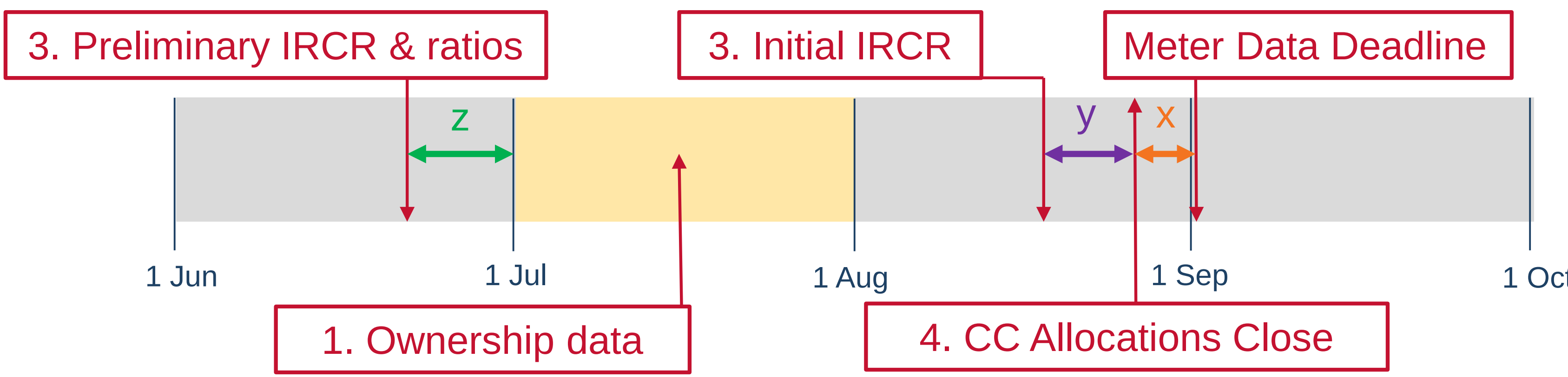

PROPOSED CHANGE
EXERCISE (TO BE PROVIDED AT WORKSHOP)

- AEMO will walk through an example which quantifies how the proposed change will work in practice:
  - o Proposed IRCR and CC Allocation processes which reduces market risk,
  - o Proposed Outstanding Amount which accurately represents participants’ exposure.

NEXT STEPS

- Market Participants are requested to provide feedback on this presentation by COB 10 March 2017.
- Please provide feedback on questions and broader proposal by email to wa.operations@aemo.com.au.
- AEMO will consider and respond to all written feedback.
- Contacts:
  - Stuart MacDougall: 08 9254 4326
  - Mark Katsikandarakis: 08 9254 4384