

Independent Market Operator

MRCPWG

Minutes

Meeting No.	10
Location:	IMO Board Room Level 3, Governor Stirling Building, 197 St Georges Terrace, Perth
Date:	Monday 20 June 2011
Time:	Commencing at 3:05 to 5:05pm

Attendees	
Allan Dawson	IMO (Chair)
Greg Ruthven	IMO
Johan van Niekerk	IMO (Minutes)
Corey Dykstra	Market Customer (3:45 – 5:05pm)
Steve Gould	Market Customer
Stephen MacLean	Market Customer
Brad Huppatz	Market Generator
Patrick Peake	Market Generator
Pablo Campillos	DSM Aggregator
Neil Gibbney	Western Power
Neil Hay	System Management (3:10 – 5:05pm)
Ben Tan	Observer
Chris Brown	Economic Regulation Authority (ERA) (Observer)
Monica Tedeschi	IMO
Rebecca Denton	IMO
Apologies	

Item	Subject	Action
1.	<p>WELCOME AND APOLOGIES / ATTENDANCE</p> <p>The Chair opened the 10th meeting of the Maximum Reserve Capacity Price (MRCP) Working Group (Working Group) at 3:05pm</p> <p>The Chair welcomed Ben Tan in attendance as an observer.</p>	
2.	<p>MINUTES OF PREVIOUS MEETING</p> <p>The minutes of the 9th MRCP Working Group meeting, held 5 May 2011, were circulated prior to the meeting.</p>	

	<p>The following amendments were agreed as per Mr Corey Dykstra's note forwarded to the IMO prior to the meeting:</p> <ul style="list-style-type: none"> • The replacement of the word "his" with "this" in the 2nd sentence of the 2nd full paragraph on page 3. • The replacement of the 2nd sentence in the 2nd full paragraph on page 7 with "Mr Dykstra noted that this was not necessarily an inconsistency as the Special Price Arrangement applied for a period of 10 years." • The replacement of the 3rd sentence of the 4th full paragraph on page 7 with "Mr Dykstra agreed and noted that there was likely to be a lower risk premium in a shorter period." <p><i>Action Point: The IMO to make the agreed amendments and publish Meeting 9 minutes on the website as final.</i></p>	IMO
3	<p>ACTION POINTS</p> <p>Mr Ruthven noted that the only outstanding item was the review of humidity rates and generator output across a range of locations. It was agreed that, since the outcomes of the MRCPWG were not dependent on the completion of the action item, the IMO would liaise with Verve Energy to ensure completion of the exercise by the IMO when resources allowed.</p>	
4	<p>FORCED OUTAGE REFUND ALLOWANCE</p> <p>Mr Ruthven detailed the results of the IMO investigation into the financial impact of forced outages as mandated by the MRCPWG at the previous meeting.</p> <p>Mr Ruthven explained that the IMO had looked at all Gas Turbines less than 10 years old with a capacity utilisation factor less than 10%, noting that the average forced outage rate for the 6 facilities in question since 1 June 2008 was 0.73%.</p> <p>Mr Tan questioned as to whether all data was being fully captured within outage reporting. Mr Ruthven confirmed that it was a requirement for all Market Participants to report accurately with respect to outages. Mr MacLean and Mr Peake agreed that there was visibility on outages due to the requirement to report and System Management access to facility availability on a real-time basis.</p> <p>Mr Huppertz noted that it was a relatively small number of facilities and that this represented potential data issues. The Chair noted that 3 years of available data for 6 facilities effectively represented 18 years of operational experience. In addition he noted that previous suggestions of higher forced outage rates in the region of 2-3% for Gas Turbines were not supported by market data. Mr Peake suggested that forced outages continued to represent a real financial challenge to some Market Participants and that sustained periods of forced outages could jeopardise ongoing operations for some.</p> <p>Mr Huppertz noted that whilst the forced outage rate was potentially small as a percentage that it was still significant on a financial level.</p> <p>The Chair noted that it was generally accepted that</p>	

	<p>implementation of an allowance for compensation for forced outages within the MRCP was not justified at present. It was noted that Mr Huppertz did not agree with the rest of the MRCPWG on this subject.</p>	
<p>5</p>	<p>ANNUALISATION PERIOD – CASHFLOW ANALYSIS</p> <p>Mr Ruthven confirmed that the IMO had engaged PricewaterhouseCoopers (PwC) to undertake an analysis of the cash-flow impact of an increase in the annualisation period within the MRCP calculation from 15 to 20 years, following the recommendation of the MRCPWG at the previous meeting.</p> <p>It was noted that the implicit assumptions made by PwC would not align with all projects. It was also noted that the analysis had been undertaken in a market characterised by high debt costs under the assumption that the project was financed at an initially high yet reducing 55% debt to total assets ratio compared to the static 40% assumed in the WACC in the Market Procedure.</p> <p>The PwC report suggested that a lengthening of the annualisation period to 20 years could reduce returns to a level below that required to support investment.</p> <p>Mr MacLean noted the high initial debt funding assumption and the relatively high hurdle rate represented by the WACC. It was noted that the WACC used in the analysis reflected the unfavourable conditions currently present in debt markets.</p> <p>Mr Huppertz suggested that there was considerable price risk which was not necessarily factored into the model. Mr MacLean noted that assets of this sort were very contestable and could be relocated to other locations if required and that the basis of any decision based on a 25 year life of the asset was perhaps underestimating its economic life.</p> <p>The MRCPWG agreed to accept the recommendation by PwC to maintain the current annualisation period of 15 years. The Chair noted the concerns of Mr MacLean.</p>	
<p>6</p>	<p>DRAFT PROCEDURE</p> <p>Mr Ruthven detailed the outcomes agreed, to date, by the MRCPWG and how they broadly impacted on the Procedure. Mr Ruthven noted that, as yet, the IMO had not assessed the impact of the inclusion of inlet cooling in the MRCP Procedure. He confirmed that there was a degree of complexity in determining the type of inlet cooling to be included.</p> <p>Mr Ruthven asked the WG what their experience was with the different inlet cooling technologies. After some discussion it was agreed that evaporative inlet cooling was possibly the most cost effective type for use in the SWIS. However the WG agreed that SKM should be asked to prepare a comparison of the main inlet cooling technologies which should determine the type incorporated in the Procedure. Mr MacLean noted that the inclusion of inlet cooling should reduce the MRCP.</p> <p><i>Action Point: The IMO to engage SKM to prepare a comparison of</i></p>	

	<p><i>the different inlet cooling options.</i></p> <p>The WG reviewed the Procedure Change Proposal. It was noted that on completion of the inlet cooling analysis by SKM that further details surrounding inlet cooling would be incorporated.</p> <p>It was noted that any changes to the MRCP Market Procedure as detailed in the proposal would only be effective from the next determination applying from 2014/15 onwards.</p> <p>Mr Ruthven presented the draft revised MRCP Market Procedure and asked for comments, noting that written comments had been received from Mr Dykstra, Mr Gibbney and Mr Peake via email.</p> <p>It was noted that additional detail on inlet cooling might be required under clause 1.5.1(f) following the outcomes of any analysis performed by SKM.</p> <p>Mr Gould suggested, and the WG agreed, that the matters dealt with under clauses 1.7.3 and 1.7.4 should be incorporated into clause 1.7.1 to improve the readability of the document.</p> <p><i>Action Point: Incorporate elements of clauses 1.7.3 and 1.7.4 under clause 1.7.1 where possible.</i></p> <p>Under Clause 1.8, Transmission Connection Works, Mr Ruthven broadly explained that the calculation of costs, where historical connection costs or relevant access offers were available, was defined under clause 1.8.1. Mr Gibbney confirmed that his draft for section 1.8, as separately distributed to the WG but not included in the draft Market Procedure, had been written with the intent of accurately expressing the agreed outcomes of the WG.</p> <p>It was confirmed that in the event of there being no actual connection cost data or access offers then clause 1.8.2 defines the basis for calculation of an estimate. It was noted that clause 1.8.2 assumes a zero deep connection cost.</p> <p>It was agreed that the IMO would clarify the handling of deep connection costs, under clause 1.8.2, with SKM. It was agreed that the IMO would provide information to the WG for comment and feedback and hold further discussions if requested.</p> <p><i>Action Point: The IMO to clarify details with regards to the non-inclusion of deep connection costs, under clause 1.8.2, with SKM.</i></p> <p>The WG broadly agreed that the clauses 1.8.1 and 1.8.2 should be updated with the comments received from Mr Gibbney.</p> <p>Under clause 1.9.4, pertaining to Fixed Operating and Maintenance Costs, Mr Gould suggested and it was agreed that the clause should be condensed to improve the readability of the document.</p> <p>Under clause 1.9.7(c), Mr Tan questioned the relevance of CPI as an input for determining ongoing fixed network access charges. Mr Ruthven confirmed that there was little visibility in this regard and Mr Gibbney agreed that it was the most satisfactory option.</p> <p>With regards to clause 1.10.2(b), under Fixed Fuel Costs, it was agreed that the clause would be removed as it effectively duplicated detail already contained under clause 1.10.1(a).</p>	<p>IMO</p> <p>IMO</p> <p>IMO</p>
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	<p>Under clause 1.12.1(b) regarding margin M, Mr Dykstra noted that there was still a question of duplication with compensation for debt financing costs allowed for under the calculation of WACC. Mr Ruthven confirmed that the IMO would review this and make any necessary changes.</p> <p>Mr Ruthven noted that clause 1.12.1(e) relating to fixed costs under margin M would be edited to ensure consistency with the rest of the document. In addition Mr Ruthven noted that the contingency cost described in clause 1.12.1(f) was ambiguous and incompatible with the rest of the Procedure. The Chair noted that the IMO intended to clarify and align the contingency provision with the current practice of applying the contingency allowance to the full Power Station cost rather than the other components of margin M.</p> <p><i>Action Point: The IMO to review and update clauses 1.8, 1.9.4, 1.10.2(b), 1.12.1(b), 1.12.1(e) and 1.12.1(f) as agreed by the WG.</i></p> <p>With regards to clause 1.13.7 detailing WACC, the Chair detailed the drafting of 1.13.7(h) included in the distributed pack as well as a revised version distributed at the meeting. He confirmed that whilst the IMO accepted that the current state of flux with regards to the ERA's proposed Bond Yield Approach, the IMO wished to clearly signal that the current methodology, using data supplied by Bloomberg, would continue to be used until such time as the regulatory validity of the ERA's methodology was decided by the Australian Competition Tribunal.</p> <p>Mr Brown stated that it was the preference of the ERA that the IMO should have more discretion with regards to the methodology used to determine the Debt Risk Premium (DRP) and that the Procedure should be suitably general in this regard to convey the discretion available to the IMO.</p> <p>The Chair stated that whilst noting the weaknesses of the current methodology, he did not want to allow any discretion in deciding the basis for calculation of the DRP as this could place the IMO in a compromising position. It was noted that the ERA was required to approve the MRCP process rather than the outcome and that undue discretion available to the IMO might result in ambiguity as to the ability of the ERA to withhold approval for publication of the final MRCP.</p> <p>It was agreed that until such time as the Australian Competition Tribunal made their final decision the IMO would continue to use the Bloomberg based methodology while clearly signalling their intent to utilise the Bond Yield Approach suggested by the ERA if it was upheld by the Australian Competition Tribunal.</p> <p><i>Action Point: The IMO to maintain the Bloomberg based methodology for the DRP whilst signalling the intent to implement the Bond Yield Approach if it is upheld by the Australian Competition Tribunal.</i></p> <p>Mr Dykstra suggested that the use of the words "Minor" and "Major" under clause 1.13.8 should be reconsidered as they didn't necessarily convey the relative importance of the parameters in question. The Chair confirmed that the IMO would look at the drafting of the section and make any useful amendments.</p> <p><i>Action Point: The IMO to make any useful amendments to the</i></p>	<p>IMO</p> <p>IMO</p> <p>IMO</p>
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	<p><i>words “Minor” and “Major” in clause 1.13.8 and any other cross referenced sections.</i></p> <p>Mr Dykstra proposed that clauses 1.15.3 to 1.15.7 inclusive be removed as they added no detail that wasn’t already sufficiently outlined earlier in the document.</p> <p><i>Action Point: The IMO to review clauses 1.15.3 to 1.15.7 and remove them if doing so would improve the Procedure.</i></p> <p>Mr Ruthven confirmed that the IMO would incorporate all agreed changes by Thursday 23 June 2011 and distribute the updated draft Market Procedure to the WG allowing 1 week for comments. It was confirmed that the Market Procedure would be provided to the Market Advisory Committee (MAC) on 6 July 2011.</p>	IMO
7	<p>GENERAL BUSINESS</p> <p>The Chair asked if there was any general business. Mr Gibbney questioned as to whether it might be prudent to implement smoothing into the annual MRCP so as to reduce annual volatility. The Chair advised that whilst smoothing could potentially reduce volatility it would result in other disadvantages in that the MRCP’s effectiveness as a marginal price signal would be reduced as it would be based on more outdated information, less reflective of current equipment costs.</p> <p>It was agreed that in the past the volatility in the MRCP had predominantly been caused by volatility in transmission costs. The Chair suggested that going forward, under the new methodology, the likelihood of continued high volatility in the MRCP was reduced.</p>	
9	<p>NEXT MEETING</p> <p>Mr Ruthven confirmed that it was anticipated that there would be no further meetings of the WG with any business being dealt with via email.</p>	
10	<p>CLOSED: The Chair declared the meeting closed at 5:05 pm.</p>	