Independent Market Operator

MRCPWG

Minutes

Meeting No.	3
Location:	IMO Board Room Level 3, Governor Stirling Building, 197 St Georges Terrace, Perth
Date:	Friday 2 July 2010
Time:	Commencing at 2:00 to 4:00pm

Attendees	
Troy Forward	IMO (Chair)
Ben Williams	IMO (proxy)
Fiona Edmonds	IMO (Minutes)
Corey Dykstra	Market Customer
John Rhodes	Market Customer (proxy)
Steve Gould	Market Customer
Patrick Peake	Market Generator
Shane Cremin	Market Generator
Brad Huppatz	Market Generator
Pablo Campillos	DSM Aggregator
Nenad Ninkov	New Investor
Neil Gibbney	Western Power
Matthew Fairclough	System Management (proxy)
Chris Brown	Economic Regulation Authority (ERA) (Observer)
Other Attendees	
Monica Tedeschi	IMO (Observer)
Rob Pullella	ERA (Observer) (3.05-4.00pm)
Apologies	
Stephen MacLean	Synergy
Alistair Butcher	System Management
Greg Ruthven	IMO

Item	Subject	Action
1.	**WELCOME AND APOLOGIES / ATTENDANCE** The Chair opened the 3rd meeting of the Maximum Reserve Capacity Price (MRCP) Working Group (Working Group) at 2:00pm.	

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	Apologies were received from: • Alistair Butcher – System Management; • Stephen MacLean – Synergy; and • Greg Ruthven – IMO. The following other attendees were noted: • John Rhodes (Proxy for Stephen MacLean); • Matthew Fairclough (Proxy for Alistair Butcher); • Ben Williams (Proxy for Greg Ruthven); • Monica Tedeschi (Observer); and • Rob Pullella (Observer). The Chair introduced Monica Tedeschi as the IMO's Graduate Analyst and requested for Miss Tedeschi to attend Working Group meetings as an Observer. The Working Group agreed for Miss Tedeschi to attend meetings as an Observer.	
2.	**MINUTES OF PREVIOUS MEETING** The minutes of the 2nd MRCP Working Group meeting, held 22 June 2010, were circulated prior to the meeting. *Page 4: Section 5: Review of MRCP Components* Mr Brad Huppatz requested the following amendment: "Mr Brad Huppatz noted that the market is put at risk if there are no ~~components~~ proponents …" Mr Matthew Fairclough requested the following clarification be included: "Mr Alistair Butcher questioned whether it is premature to seek consultancy advice if the Working Group has not yet agreed whether costs should be optimised or based on a real or hypothetical power station." Mr Corey Dykstra requested the following sentence be amended and moved to the section of the minutes on deep connection costs: "Mr Dykstra noted that the attribution of deep connection costs ~~will~~ may be partially set by the Western Australian regulatory framework. Mr Dykstra also noted that the ERA is likely to be interested in an answer to this." *Page 5: Section 5: Review of MRCP Components* Mr Fairclough requested the following clarification be included: "…deep connection costs would be expected to be less than being built else where, but deep connection costs may be very location specific." Mr Dykstra requested the following amendment:	

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	"The Working Group agreed that Western Power ~~is the~~ would be the appropriate party… Agreed Outcome: ~~Western Power is the appropriate party to determine s~~Shallow connection costs to be provided by Western Power." *Page 6: Section 5: Review of MRCP Components* Mr Dykstra requested the following deletion: ~~"Mr Dykstra noted that an efficient level of investment needs to be encouraged."~~ *Page 7: Section 5: Review of MRCP Components* Mr Chris Brown requested the following deletion: "In response the Chair noted ~~that~~ that if …" *Action Point: The IMO to amend the minutes of Meeting 2 to reflect the points raised by the Working Group and publish on the website as final.*	**IMO**
3	**ACTION POINTS** The actions arising were either complete or on the meeting agenda. The following exceptions were noted: Action Item 9 – Mr Ben Williams noted that this action item was now complete with the Scope of Works: Calculation Methodology to be applied in determining deep connection costs on the agenda for discussion during today's Working Group meeting. Action Item 10 – Mr Williams noted that in the case where no Market Participants bid into the Reserve Capacity Auction then the price will be set at 85% of the MRCP. Action Item 11 – Mr Williams noted that this action item was now complete with the Scope of Works: Calculation Methodology to be applied in determining the Weighted Average Cost of Capital (WACC) on the agenda for discussion during today's Working Group meeting. Action Item 13 – Mr Dykstra queried whether it may be more efficient for the IMO to get advice from LandCorp on what services it could provide the Working Group and distribute to members. The IMO agreed to amend the action item to reflect this. *Action Point: The IMO to update the MRCPWG Action Point register as follows:* *"Action Item 13: The IMO request advice from ~~to organise for~~ LandCorp ~~to present to the Working Group~~ on what services it can offer for the purposes of determining the MRCP. The IMO to distribute advice to Working Group members for their consideration."*	**IMO** **IMO**

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4a	**SCOPE OF WORKS: CALCULATION METHODOLOGY TO BE APPLIED IN DETERMINING DEEP CONNECTION COSTS** The IMO presented the scope of works it had prepared for the review of deep connection costs. The following points were raised by members: • Mr Neil Gibbney noted that the outcomes and implication of New Facility Investment Test (NFIT) and the capital contributions policy is a large consideration. Mr Gibbney suggested the ERA provide further guidance on whether the Consultant should review whether the recommended calculation methodology would pass both the NFIT and capital contributions policy. • Mr Gibbney noted that the scope of works does not state that the solution needs to be consistent with the Market Objectives. In response, Mr Shane Cremin noted that there is no direct relationship with the Wholesale Market Objectives and that the technical code may be more relevant for deep connection costs. *Action Point: The IMO to amend the Scope of Works to include a link to the Technical Rule requirements.* • Mr Cremin questioned whether a prescriptive outcome was being sought and whether the ERA should develop a similar method to enhance transparency of the transmission process. In response, Mr Chris Brown noted that this would require a different framework to be developed. • Mr Pablo Campillos noted that a side-by-side comparison of Wester Power's current calculation and any identified alternative methods would be beneficial. Mr Dykstra noted that any alternative approaches will need to be within the constraints of the current regulatory environment. Mr Cremin noted the difficulties in identifying the net benefits resulting from construction at different sites. • Mr Dykstra noted that the scope of works should be more precise as to what needs to be reviewed by the Consultant. • Mr Campillos suggested expanding the assumptions to cover those made by both the IMO and Western Power. *Action Point: The IMO to amend the scope of works to cover the assumptions made by both the IMO and Western Power.* • Mr Nenad Ninkov questioned whether the Consultant would provide estimates of deep connection costs. The Working Group agreed that the purpose of the Consultant's work is to develop an appropriate methodology, present the methodology and re-calculate the 2009 results using the amended methodology. Mr Fairclough questioned whether the Consultant would review the methodology to determine whether it would pass both the capital contribution policy and Western Power's NFIT test. Mr Brown agreed that the review should cover this. *Action Point: The IMO to circulate to Working Group members a*	**IMO** **IMO** **IMO**

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	word version of the Scope of Works: Calculation Methodology to be applied in determining Deep Connection Costs *Action Point: Working Group members to provide suggested amendments to the IMO on the Scope of Works: Calculation Methodology to be applied in determining Deep Connection Costs by 23 July 2010.* • Mr Ninkov suggested that a definition of deep connection costs should be developed. Mr Brad Huppatz questioned if a Market Participant can appeal to the ERA or Western Power if it disagrees with Wester Power's decision of what a deep connection cost is. Mr Dykstra noted that it is a responsibility of the connecting generator to determine if the value is consistent with the regulatory requirements for determining the values when it is provided the quantum of capital contribution. *Action Point: The IMO to develop a definition of deep connection costs and provide to Working Group members for review.* *Action Point: The IMO to include a request for details of the regulatory regime in the Scope of Works: Calculation Methodology to be applied in determining Deep Connection Costs.*	**Working Group** **IMO** **IMO**
4b	**SCOPE OF WORKS: CALCULATION METHODOLOGY TO BE APPLIED IN DETERMINING THE WEIGHTED AVERAGE COST OF CAPITAL** The IMO presented the scope of works it had prepared for the review of the WACC methodology. The following points were raised by members: • Mr Dykstra questioned why the Working Group would be asking the same questions regarding the methodology again unless the situation had changed since the last review. Mr Williams noted that during the 2009 review the Consultant had suggested new Major parameters; as a result the IMO wants the Consultant to review whether these are appropriate. Mr Williams also noted that the inclusion of debt financing costs in both the margin M and WACC variables means that there is potential double counting currently. • The Chair noted that the construct of the Market Rules needs to be taken into account when preparing the WACC. One of the questions to be answered is whether the risk component in the WACC should take into account the risk of not going into the auction. The Chair noted that the determination by the Allen Consulting Group three years ago didn't take into account the risk of not getting the project funded at all because it does not enter the auction. Mr Dykstra noted that this is a project-specific risk and should be determined for the set of activities associated with the organisation. Mr Dykstra stated that it is for this reason that the set of similar companies is used in the methodology for determining the WACC. • Mr Rob Pullella questioned whether the original study took into account a similar company in the National Electricity	

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	Market (NEM) as they would not face the same risk as in the WEM (Equity Beta). Mr Pullella suggested that risk may be higher than in the NEM. Mr Cremin disagreed, stating that a Market Participant could potentially lose all its Capacity Credits in one or two months. Mr Pullella noted NEM participant are not paid an income associated with Capacity Credits. • Mr Brown suggested that the assumption for MRCP is that a proponent is a single project. Mr Pullella considered that the equity beta should be lower in the WEM than the NEM as there is a capacity market. Mr Patrick Peake noted that difference in the WEM is that Capacity Credits could be the sole income of a generator. • Mr Peake noted that the money that a proponent could receive from the auction needs to be enough to cover previous development work. While this is a risk to all developers in the WEM, if capacity is to be encouraged onto the market then this needs to be taken into account. Mr Peake suggested that project specific risk could be incorporated into the margin M calculation. • Mr Campillos suggested that the risk of not getting the project up in time might be included across a proponent's entire development portfolio which would potentially inflate costs. • The Chair questioned when the outcomes from the original review undertaken by the Allen Consulting Group should be maintained. Mr Ninkov noted the Working Group needs to decide if the WACC is based on a single stand-alone facility or one which comprises part of a portfolio. • Mr Dykstra noted that there will be a wide range of values for the asset and beta variables for each of the companies in the comparator companies list. Mr Dykstra noted that the Working Group needs to make a decision as to whether the entry of new units into the WEM is more or less risky than other activities. The Chair suggested that the Consultant provide advice on how the WACC is determined. The Chair noted that in appointing a Consultant to undertake the review a competitive tender process will be undertaken. *Action Point: The IMO to provide a copy of the Allen Consulting Group initial review and the Word document for the Scope of Works: Calculation Methodology to be applied in determining the WACC to Working Group members.* *Action Point: Working Group members to provide comments on the Scope of Works: Calculation Methodology to be applied in determining the WACC (in particular the definition of margin M) and on whether the Allen Consulting Group's initial recommendations are still valid by 23 July 2010.*	**IMO** **Working Group**
5	**REVIEW OF MRCP COMPONENTS** The Working Group continued to discuss the components of the MRCP which may require the input of consultants. ***Power Station – Capacity (160MW assumption)*** • Mr Williams noted that the deep connection costs associated	

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	with a 160MW unit may not be the same as those encountered in connecting a 155MW unit and suggested the Consultant consider whether the value of 160MW be explicitly stated or if variation around this value should be allowed. Mr Steve Gould agreed that this was an issue. The Chair suggested that the sensitivity around the review of 2009 numbers would change if the 160MW basis is amended by incremental amounts. The Chair noted that this would be a scoping exercise and not undertaken each year. • Mr Cremin noted although there are likely to be large deep connection costs associated with building a 160MW unit it is unlikely that one will be connected as there are currently no appropriate sites available. As a result smaller units are more likely to enter the market. The Chair noted that problem with investing in infrastructure is a much larger issue which is outside the scope of the Working Group. • Mr Fairclough noted that the 160MW level was set in 2005 when the system had the capacity to connect new units. Mr Fairclough questioned whether this initial assumption is still relevant given system constraints. Mr Ninkov noted that the Working Group is developing a methodology for determining the MRCP to apply for the next five years during which further units are likely to enter the WEM. Mr Williams noted that the methodology should be robust to changes in circumstances. Mr Dykstra noted that the methodology should be simple and reflect a reasonable process. As size of the unit being connected to the system will drive the deep connection costs the Working Group agreed that this issue needs to be discussed and resolved prior to the Consultant undertaking the review. • Mr John Rhodes questioned the size of units which have been recently entering the WEM. The Chair clarified that these have generally been smaller units. • The Chair noted that a notional unit of 40MW is used for the purposes of the determination of the Energy Price Limits. It was noted that a 40MW unit is not inconsistent with providing load following services. Mr Cremin noted that if a proponent builds a smaller machine they will still have similar overheads associated with transmission connection. The Chair suggested that the Working Group could look at using the Statement of Opportunities for these purposes, including reserve (load) forecasting. The Chair also noted that the first MRCP review included a price/quantity curve on a megawatt basis and that the price determined fitted well with 160MW band. • Mr Campillos questioned whether the Working Group should review the likeliness of a new entrant wanting to connect a 160MW plant given the current transmission constraints. In response, Mr Williams noted that the MRCP needs to apply for the next 5 years and should therefore be dynamic. Mr Williams suggested that an optimised model should be considered as it would allow for changes in the costs of transmission for different sized generators. Mr Dykstra noted that the Working Group needs to determine what the incremental block of capacity to secure in a shortfall situation	

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	would be. Mr Dykstra noted that the second stage issue relates to the appropriate way to secure the required capacity. Mr Dykstra noted that a clear Market Procedure is a pre-requisite to assisting this process. • Mr Ninkov noted that the Working Group needs to take into consideration what size of unit would most likely be offered into the auction. Mr Ninkov considered that it is most likely that only a large plant will be progressed far enough through the process to enter into the auction (e.g. have their finance organised, approvals etc). • Mr Cremin questioned whether the MRCP should be a price cap, similar to the methodology adopted in determining the Energy Price Limits. The Chair noted that the IMO needs to provide a reasonable price that would allow someone to recover capital cost and make a reasonable return. Mr Peake noted that as network costs of development are high it would be useful to be provided with estimated costs and build sites from Western Power. *Action Point: The IMO to provide Working Group members with a copy of the work previously undertaken by Sinclair Knight Merz for the first MRCP review.* *Action Point: The IMO to undertake analysis of native demand growth, excluding block loads, and provide to Working Group members by 23 July 2010.* *Action Point: Perth Energy to provide the IMO with details of the cost curve for a gas turbine by 14 July 2010. The IMO to distribute this material to Working Group members.*	**IMO** **IMO** **Perth Energy**
6	**GENERAL BUSINESS** There was no general business raised.	
7	**NEXT MEETING** The next Working Group meeting is currently scheduled to be held Tuesday 17 August 2010 (3:00-5:00pm). *Action Point: The IMO to confirm the next meeting date and provide details to all Working Group members.*	**IMO**
8	**CLOSED:** The Chair declared the meeting closed at 4.00 pm.	