

Independent Market Operator

MRCPWG

Minutes

Meeting No.	6
Location:	IMO Board Room Level 3, Governor Stirling Building, 197 St Georges Terrace, Perth
Date:	Thursday 20 January 2011
Time:	Commencing at 3:00 to 5:30pm

Attendees	
Troy Forward	IMO (Chair)
Johan van Niekerk	IMO (Minutes)
Greg Ruthven	IMO
Monica Tedeschi	IMO
Corey Dykstra	Market Customer
John Rhodes	Market Customer
Steve Gould	Market Customer
Shane Cremin	Market Generator
Brad Huppatz	Market Generator
Neil Gibbney	Western Power
Ray Challen	Price Waterhouse Coopers (PwC) (3.00-4.35pm)
Geoff Glazier	Sinclair Knight Merz (SKM)
Chris Brown	Economic Regulation Authority (ERA) (Observer)
Duc Vo	Economic Regulation Authority (ERA) (Observer) (3.00-4:35pm)
Robert Pullella	Economic Regulation Authority (ERA) (Observer) (4.00-5:30pm)
Apologies	
Stephen MacLean (John Rhodes)	Market Customer

Item	Subject	Action
1.	<p>WELCOME AND APOLOGIES / ATTENDANCE</p> <p>The Chair opened the 6th meeting of the Maximum Reserve Capacity Price (MRCP) Working Group (Working Group) at 3:00pm.</p> <p>An apology was received from Mr Stephen MacLean (Market Customer). Mr John Rhodes was welcomed in place of Mr MacLean.</p> <p>It was noted that Mr Nenad Ninkov was no longer employed by Pacific Energy, and that a nominated replacement would be</p>	

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	proposed to the Market Advisory Committee at its February meeting.	
2.	<p>MINUTES OF PREVIOUS MEETING</p> <p>The minutes of the 5th MRCP Working Group meeting, held 15 September 2010, were circulated prior to the meeting. The following amendment to page 3 was agreed:</p> <ul style="list-style-type: none"> • Mr Gibbney noted that even the smallest transmission lines displaying reasonable economies of scale have a capacity of 250MW, which is considerably more more capacity than required by a new 160MW generator. Further augmentations to the transmission network actually tend to be even more 'lumpy' in nature in that new transmission lines can quite easily have capacities around 750MW. Consequently, the most significant issue is not what a new line costs, but how you allocate the costs to each customer. Mr Gibbney noted that under the Access Code once a new transmission facility is added to Western Power's capital base then Western Power can no longer charge capital contributions for use of that facility and new generators can essentially get a free connection. <p>The following paragraph on page 3 and 4 was removed as it was agreed it was unnecessary:</p> <ul style="list-style-type: none"> • Mr Dykstra noted that load growth has been recently driving the need for increased connections. Application of the current regulatory provisions creates volatility around these costs which can have a significant effect on the viability of a project. Additionally Mr Cremin noted that there may be a situation where the market already has considerable generation available and an investor wants to add extra capacity which is not required. This would present the ERA with an interesting situation to consider. <p><i>Action Point: The IMO to make the agreed amendments and publish Meeting 5 minutes on the website as final.</i></p>	IMO
3	<p>ACTION POINTS</p> <p>The actions arising were either complete or on the meeting agenda. Mr Greg Ruthven noted the following exceptions:</p> <ul style="list-style-type: none"> • AP36: The IMO will present a draft updated Market Procedure, allowing for the inclusion of inlet cooling in the power station costs, to a subsequent meeting. • AP37: The IMO to initiate a review of the relationship between humidity rates and generator output across a range of locations. This review is still pending. • AP39: The IMO to seek clarification from SKM on the components included in its assessment and seek advice on whether they consider there is a better way to determine Margin M. This point would be discussed with Mr Geoff Glazier from SKM later in the meeting. 	

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4	<p>WEIGHTED AVERAGE COST OF CAPITAL METHODOLOGY – DRAFT REPORT</p> <p>Mr Ray Challen from PwC presented the draft report including a review of the method of calculation of the Weighted Average Cost of Capital (WACC) and other elements used in the procedure to determine the Maximum Reserve Capacity Price (MRCP).</p> <p>The following comments were noted:</p> <ul style="list-style-type: none"> Mr Duc Vo of the ERA confirmed that the ERA’s preference is for a real pre-tax WACC as this did not require a possibly complicated review of the tax characteristics of applicable industries and individual companies. <p>Mr Corey Dykstra noted that the use of a pre-tax basis might lead to a possible over compensation for costs but that the use of the corporate tax rate to calculate a post-tax value was a reasonable proxy.</p> <p>Members generally agreed that the IMO continue with the use of a real pre-tax WACC.</p> <p><i>Agreed Outcome: The IMO to continue using WACC on a real pre-tax basis.</i></p> <ul style="list-style-type: none"> Mr Dykstra noted that the current Market Procedure provided a different approach to inflation with a possible conflict between the use of state versus federal numbers. Mr Challen stated that the use of Australia-wide numbers published by the Reserve Bank of Australia (RBA) is regarded as best practice as the intention was to calculate a WACC value for an Australian, and not just a Western Australian, investor. Mr Shane Cremin questioned the relevance of using international gearing ratios which were heavily influenced by international tax regimes related to the treatment of debt. Mr Cremin and Mr Rhodes stated that a 0.40 gearing ratio was more representative of Western Australian developers and that a reduction in the gearing ratio might not sufficiently compensate investors. They believed that the case had not been sufficiently made for a reduction from 0.40 to 0.35. Mr Dykstra noted the potential difference in gearing between individual projects and on a corporate level. <p>Mr Rhodes stated that there was potentially an increasing appetite for debt as a financing source particularly considering the increasing familiarity of the market with the Reserve Capacity process.</p> <p>Mr Challen stated that it was the intention to use best estimates based on established benchmarks in performing the WACC calculation rather than seeking to justify any changes.</p> <p>The Chair noted the validity of both arguments and requested that members comment on this and other aspects of the PwC report within 2 weeks. The IMO would take all views into account and would present a recommendation at the next meeting.</p>	

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	<ul style="list-style-type: none"> <li data-bbox="427 179 1246 412">• Mr Vo noted that the ERA considers the debt risk premium to be too high, and confirmed that the ERA is working on an alternative methodology. Mr Robert Pullella advised that the ERA would provide further guidance in this regard once their investigation was finalised. Mr Pullella confirmed they would have an alternative proposal available for distribution within the next 2 months. <p data-bbox="475 432 1246 701">The Chair questioned whether it might be prudent to revisit the methodology for this parameter on an annual basis based on professional judgment. Mr Dykstra stated that whatever methodology was used should signal boundaries to participants to allow for accurate planning. The Chair confirmed that the IMO would have a discussion with the ERA to ascertain the status of their investigation in order to provide feedback.</p> <p data-bbox="379 748 1246 817"><i>Action Item: ERA to provide details of proposed alternative Debt risk premium methodology to IMO.</i></p> <ul style="list-style-type: none"> <li data-bbox="427 837 1246 1137">• Mr Brad Huppatz questioned how the proposed methodology, based on a return on the construction costs for half of the construction period (PwC having suggested a nominal construction period of 12 months), would relate to the Reserve Capacity Cycle pointing out that such a revision would imply that the power station could be completed just in time to deliver capacity as required by the Reserve Capacity process, without allowing sufficient time for commissioning. <li data-bbox="427 1158 1246 1285">• Mr Challen confirmed his belief that a revised procedure on this basis would better represent the financing costs if construction was undertaken in an economically efficient manner. <li data-bbox="427 1305 1246 1433">• It was noted that there may be potential discrepancies between the calculation of the Margin cost (legal, insurance, financing, environmental approval costs) value between the PwC and SKM reports. <p data-bbox="379 1458 1246 1527"><i>Action Item: IMO, in conjunction with SKM and PwC, to review potential discrepancies in the calculation of Margin cost.</i></p> <p data-bbox="379 1547 1246 1617">Mr Ruthven requested that Working Group members provide any additional feedback by 5pm on Thursday 3 February 2011.</p> <p data-bbox="379 1641 1246 1711"><i>Action Item: Working Group members to provide feedback on the PwC report to the IMO by 5pm on Thursday 3 February 2011.</i></p>	<p data-bbox="1337 768 1401 797" style="text-align: center;">ERA</p> <p data-bbox="1305 1469 1433 1538" style="text-align: center;">IMO/SKM /PwC</p> <p data-bbox="1281 1675 1457 1704" style="text-align: center;">All Members</p>
5	<p data-bbox="379 1756 1098 1825">DEEP CONNECTION COSTS – PRESENTATION ON METHODOLOGY</p> <p data-bbox="379 1856 1246 1926">Mr Geoff Glazier from SKM presented the draft report on Deep Connection Costs (DCC).</p> <p data-bbox="379 1957 863 1986">The following comments were noted:</p> <ul style="list-style-type: none"> <li data-bbox="427 2027 1246 2119">• The question of the weighting of historical data versus forecasts was raised as an issue with Mr Dykstra proposing that more recent data should be weighted more 	

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	<p>heavily. Mr Glazier indicated that this could be incorporated in any model with a view to finding a balance between short term volatility and historical costs.</p> <ul style="list-style-type: none"> • Mr Cremin questioned the consistency of heavily weighting short run costs with the risk being that a period of generation shortage may co-incide with a shortage of transmission capacity resulting in short term upward pressure on DCC. • The Chair proposed that in order to progress further that SKM should obtain more data from Western Power to develop the model further. It was noted by Mr Neil Gibbney that there was an extremely small data set as there were a limited number of large transmission upgrades undertaken in recent years. It was agreed that Mr Glazier and Mr Gibbney would discuss this outside of the meeting. <p><i>Action Point: SKM and Western Power to discuss data availability in order to supply data to SKM with a view to further investigating option 2 (Forecast DCC based on Historic Connection Costs Data).</i></p> <ul style="list-style-type: none"> • It was noted that any model would be based on the constraint of a 160 MW plant as previously agreed and that SKM and Western Power would proceed on this basis. <p><i>Agreed Outcome: It was agreed that SKM's next report would contain more detail surrounding projections based on the agreed constraints of a 160 MW plant.</i></p> <ul style="list-style-type: none"> • Mr Dykstra questioned the impact that any Western Power assumptions on network tariff increases might have on outcomes. Mr Gibbney advised that changes in tariffs were difficult to forecast and that Western Power was not prepared to make forecasts in this regard. <p><i>Action Point: Working Group members to provide feedback on the SKM report to the IMO by 5pm on Thursday 3 February 2011.</i></p>	<p>SKM/Western Power</p> <p>SKM</p> <p>All Members</p>
5	<p>GENERAL BUSINESS</p> <p>There was no general business raised.</p>	
6	<p>NEXT MEETING</p> <p>Mr Ruthven noted that the next meeting would be held on Thursday 17 February 2011.</p>	
7	<p>CLOSED: The Chair declared the meeting closed at 5.30 pm.</p>	