

Independent Market Operator

MRCPWG

Minutes

Meeting No.	8
Location:	IMO Board Room Level 3, Governor Stirling Building, 197 St Georges Terrace, Perth
Date:	Thursday 24 March 2011
Time:	Commencing at 3:05 to 5:05pm

Attendees	
Troy Forward	IMO (Chair)
Greg Ruthven	IMO
Monica Tedeschi	IMO
Johan van Niekerk	IMO (Minutes)
Corey Dykstra	Market Customer
Steve Gould	Market Customer
Stephen MacLean	Market Customer
Shane Cremin	Market Generator
Brad Huppatz	Market Generator
Patrick Peake	Market Generator
Pablo Campillos	DSM Aggregator
Neil Gibbney	Western Power
Neil Hay	System Management
Geoff Glazier	Sinclair Knight Merz (SKM) (3:30 – 5:05pm)
Duc Vo	Economic Regulation Authority (ERA (Observer) (3:20 - 4:10pm)
Chris Brown	Economic Regulation Authority (ERA (Observer) (3:50 – 5:05pm)
Apologies	

Item	Subject	Action
1.	WELCOME AND APOLOGIES / ATTENDANCE The Chair opened the 8th meeting of the Maximum Reserve Capacity Price (MRCP) Working Group (Working Group) at 3:05pm.	
2.	MINUTES OF PREVIOUS MEETING The minutes of the 7th MRCP Working Group meeting, held 17 February 2011, were circulated prior to the meeting. They were accepted with a correction to the spelling of Western Power in the	

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	<p>action column on page 3.</p> <p><i>Action Point: The IMO to publish Meeting 7 minutes on the website as final.</i></p>	IMO
3	<p>ACTION POINTS</p> <p>Mr Greg Ruthven noted the following actions that were not completed:</p> <ul style="list-style-type: none"> • 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. Mr Ruthven confirmed this should be completed in time for the meeting on 5 May 2011. • AP40: Mr Ruthven advised that the Economic Regulation Authority (ERA) had completed its work on an alternative Debt Risk Premium methodology. This would be presented by Dr Duc Vo of the ERA later in the meeting. • AP43: SKM and Western Power had exchanged data regarding Transmission Connection Costs and the results would be presented by SKM later in the meeting. • AP47/52: It was confirmed that Worley Parsons had been appointed, subject to agreement of terms and conditions, to undertake the exercise to independently provide a Margin M calculation and a view on forward-looking cost escalation factors. <p>As Mr Geoff Glazier was yet to arrive it was agreed that the discussion of the SKM Research Report would be delayed till later in the meeting.</p>	
4	<p>SUBMISSIONS FROM 2011 MRCP DETERMINATION</p> <p>Mr Ruthven noted the comments received with regards to escalation factors. As previously noted it was anticipated that the Worley Parsons report would be available for the next meeting to allow further consideration of this component.</p> <p>With regards to volatility in the MRCP, Mr Ruthven confirmed that this subject would form part of the final discussions of the Working Group.</p> <p>Mr Ruthven detailed the comments received in respect of allowances for insurance costs in the MRCP, for the period after commencement of plant operation. After some discussion it was agreed that there was validity in classing insurance expenses as a fixed cost and that the IMO should investigate the components of insurance costs during plant operation and calculate a variable for inclusion in future MRCP calculations.</p> <p><i>Action Point: The IMO to include ongoing insurance costs for the period following plant construction within the fixed O&M component in future MRCP calculations.</i></p> <p>Mr Ruthven detailed the physical restrictions with regards to minimum land size available at certain locations which conflicted somewhat with the MRCP Procedure. It was agreed that for future MRCP calculations that the land size used would continue</p>	IMO

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	<p>to be 3 hectares but where the minimum land size able to be purchased at any specific location was more than 3 hectares that that minimum specific land size would be used for the calculation of a MRCP price for that specific location.</p> <p><i>Action Point: The IMO to amend the Market Procedure to incorporate variability of land size when determining the Land Cost for locations where 3 hectare blocks are unavailable.</i></p> <p>Mr Ruthven detailed the comments received regarding the capitalisation period (currently 15 years) used in determining the MRCP. Mr Corey Dykstra stated that there was a potential mismatch between the 15 years used for capitalisation of expenses versus an economic life for plant of potentially 30-40 years. He outlined the potential for the MRCP in its current form to over-compensate investors.</p> <p>Mr Stephen MacLean stated that power generation technology was continuing to develop and that this represented potential risks to current plant viability as new technology had the potential to make current plant comparatively less efficient. Mr MacLean stated that despite the potential for developments in this area to potentially reduce future investment returns for current technology, Open Cycle Gas Turbines (OCGT) could be re-located if it made economic sense to do so.</p> <p>In addition Mr Patrick Peake detailed that there were substantial maintenance cost implications for OCGT plants after 15 years, where complete re-builds of parts of a plant might be required.</p> <p>Mr Pablo Campillos voiced his concern that there continued to be real risks that plant could become obsolete in the future and that any lengthening of the capitalisation period should take into account these risks. Mr Peake mentioned fuel cells as having real potential to impact on OCGT viability in the future.</p> <p>It was noted that even taking into account consideration of plant obsolescence and maintenance that a lengthening of the capitalisation period would most likely result in a lower MRCP determination. Mr Neil Gibbney questioned as to whether a lengthening of the capitalisation period and likely reduction in the MRCP might significantly reduce the attractiveness of new investment. Mr MacLean suggested that increased competition in the market might encourage an acceptance of a longer capitalisation period.</p> <p>Mr Peake advised that over a long term investment, the variability in MRCP represented a significant risk for investors and that bank finance would be more difficult to obtain if the capitalisation period was increased resulting in an expected reduction in capacity-based income. This might lead to significant funding issues for investors in new capacity.</p> <p>The Chair proposed that the IMO should investigate the issues discussed and formulate a view on the impact of lengthening the capitalisation period taking the issues into account under a number of possible scenarios. The Group agreed that the IMO should perform an investigation as discussed.</p> <p><i>Action Point: The IMO to investigate the issues surrounding a change in the capitalisation period, and the impact on the MRCP, and present the results at the meeting on 5 May 2011.</i></p>	<p style="text-align: center;">IMO</p> <p style="text-align: center;">IMO</p>

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5	<p>WEIGHTED AVERAGE COST OF CAPITAL - DEBT RISK PREMIUM</p> <p>The Chair introduced Dr Vo from the ERA to make a presentation on the ERA bond-yield approach to calculating a Debt Risk Premium (DRP), as published in the ERA's Final Decision on WA Gas Networks (WAGN).</p> <p>The presentation is attached as Appendix A.</p> <p>Mr Dykstra commented that while the ERA approach may have some validity it was not as yet recognised as a valid approach and that the Australian Competition Tribunal would be called to review the methodology as used with particular reference to its consistency with national gas laws. Mr Vo advised that a similar methodology to that proposed by the ERA had been accepted and utilised in New Zealand over the last 5-7 years.</p> <p>Mr Ruthven advised that it was likely that the appeal process would be finalised by the end of 2011. Mr Dykstra suggested that until there was clarity there was validity in continuing to use the current methodology, in the absence of a valid and accepted alternative.</p> <p>Mr Dykstra proposed that the MRCP Procedure should allow some flexibility in the methodology used in calculating the DRP and at this stage, until clarification had been obtained, the IMO should still be have the option to use the current methodology.</p> <p>The Chair proposed that the IMO should also undertake a sensitivity analysis to estimate the impact on the MRCP of any change from the use of the current methodology to that proposed by the ERA. The Group agreed that the IMO should perform the sensitivity analysis and present the results at the next meeting.</p> <p><i>Action Point: The IMO to investigate the issues surrounding a change in the DRP calculation methodology, and the impact on the MRCP, and present the results at the meeting on 5 May 2011.</i></p>	IMO
6	<p>DEEP CONNECTION COSTS – RESEARCH REPORT</p> <p>Mr Glazier provided a detailed summary of the content of the Research Report including assessment criteria used for methodology selection, market objectives and related criteria, issues in defining Deep and Shallow Connection Costs and an audit of the Western Power process. It was confirmed, as previously agreed, that the preferred methodology was based on actual historical connections costs with access offers from the current year.</p> <p>Mr Glazier confirmed that there was a limited data set which presented some challenges but that this methodology had a more representative data set than the current methodology.</p> <p>Mr Glazier noted that the data provided wasn't necessarily uniform in that some costs were included in some data points used while others were not. This would be the case where a</p>	

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	<p>measure of Total Connection Costs (TCC) for a project did not include transmission connection costs borne directly by the Customer whereas these costs might be charged to the Customer by Western Power for other projects. It was noted that before finalising the report there would be an audit and cleanup of data.</p> <p>Mr Glazier confirmed that the only significant change from the previous report was the inclusion of the trend graph following the update of the model with data by Western Power. He confirmed that some verification was still required but that the trend graph was reflective of the data provided.</p> <p>Mr Glazier confirmed that the proposed methodology produced a TCC of \$127,000 per MW compared to \$305,000 per MW in the 2011 MRCP under the current methodology, representing a 58% decline in connection costs.</p> <p>It was confirmed that actual TCC for the last 5 years were maintained in the calculation with a greater weighting given to more recent periods. In addition access offers, for the current year, were utilised in the calculation of TCC. It was confirmed that access offers would be used in the calculation of TCC only for the current year with access offers from previous years not included in the calculation.</p> <p>Mr Glazier stated that the forecast for TCC was based on what was actually happening in the market with some participants finding innovative solutions to connect to the system in a cost efficient manner. It was noted that despite any issues with sample size, which was relatively small, that this represented a superior methodology than currently employed which depended on more limited data.</p> <p>Mr Peake questioned as to whether potential new entrants had any knowledge of efficient locations, with regards to TCC, to build new capacity and that this may lead to a disconnection between the model and actual connection costs for less opportunistic new capacity.</p> <p>Mr Gibbney stated that the data generated was based on very opportunistic access to the system and that future capacity growth might be hindered if the MRCP was not high enough. In addition he stated that the calculation generated by the proposed methodology of \$127,000 per MW was not comparable with the estimated replacement cost of the total Western Power network of \$600,000 per MW. Mr Glazier confirmed the objective of the model in this regard was to reflect an efficient marginal position.</p> <p>The Group agreed the proposed methodology, based on historical costs with current access offers, should be adopted with Western Power and SKM to complete any cleanup of data and finalise the report for the next meeting.</p> <p><i>Action Point: Western Power and SKM to complete any cleanup of data, and SKM to finalise the Research Report.</i></p> <p>In addition it was agreed that the IMO should investigate the likely</p>	<p>Western Power/SKM</p>

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	<p>impact of the proposed change in the TCC calculation methodology and the impact of any change on the MRCP.</p> <p><i>Action Point: The IMO to investigate the issues surrounding a change in the TCC calculation methodology, and the impact on the MRCP, and present the results at the meeting on 5 May 2011.</i></p>	IMO
5	<p>GENERAL BUSINESS</p> <p>Mr Chris Brown advised that he had a number of queries regarding the draft Market Procedure which he would forward via email, following the meeting. It was agreed that Members should forward any comments outside of the meeting.</p> <p><i>Action Point: Any comments regarding the proposed MRCP Procedure to be forwarded via email to the IMO.</i></p>	All
6	<p>NEXT MEETING</p> <p>Mr Ruthven noted that the next meeting would be held on Thursday 5 May 2011. It was agreed that depending on the nature of business to be discussed it might be necessary to allocate three hours for the meeting. Mr Ruthven confirmed that he would confirm this with prospective attendees closer to the next meeting date.</p> <p><i>Action Point: Mr Ruthven to advise prospective attendees of the meeting details closer to the next meeting date.</i></p>	IMO
7	<p>CLOSED: The Chair declared the meeting closed at 5:05 pm.</p>	