perthenergy

20 November 2008

Manager Market Administration
Independent Market Operator
Level 3, Governor Stirling Tower
197 St George's Terrace Perth WA 6000

RC_2008_27 – Funding of Supplementary Reserve Capacity

Dear Sir

Perth Energy appreciates the opportunity to make comment on proposed rule change no 2008_27 in respect to the funding of Supplementary Reserve Capacity (SRC). I understand that the IMO has retained McLennan Magasanik Associates (MMA) to assist in this assessment and I am pleased to provide this submission to support the work being undertaken by the IMO and MMA.

At present, as noted in the IMO draft Rule Change Report, SRC Costs are assigned as part of the Targeted Reserve Capacity Cost. Also, the Targeted Reserve Capacity Cost is assigned on the level to which a Market Customer has not secured Capacity Credits. The advantage of this approach is that it encourages Market Participants to trade bilaterally because a customer who has covered its exposure through bilateral contracts does not face further costs arising from the acquisition of SRC.

It is Perth Energy's opinion that this benefit is outweighed by several major disadvantages.

Risk to Market Participants

The most significant is that a Market Customer may not have been able to secure Capacity Credits bilaterally or may temporarily be uncontracted (such as during contract negotiations). The Customer could be faced with meeting a proportion of the SRC Cost that is substantially higher than its Capacity Credit obligation.

A smaller Market Participant could face severe economic stress if it were required to carry a substantial share of the SRC costs. For example, when SRC was contracted recently, the quantity secured was very large in comparison to the size of several smaller Market Participants. If the SRC had been called, and if one of these smaller Market Customers had been required to shoulder a significant share of the total SRC costs, it is likely that they would have been forced from the market.

Forcing a Market Participant to exit the market would reduce market competition which is in direct conflict with the second Market Objective. It is also likely that the exiting Market Participant would have had uncovered trading losses that would have had to be assigned to the remaining Market Participants.

Inequitable Allocation of SRC Costs

Where SRC has been called to cover the non-availability of generating plant, it is possible for the entity that owns this plant to be completely exempted from making any contribution towards the SRC costs. A generator that experiences a major forced outage will generally retain any Capacity Credits that it has been assigned. Where these have been bilaterally traded to a Market Customer which is fully bilaterally contracted, the Customer will make no contribution towards the SRC even though "its" generator is the cause of the capacity shortfall.

t (08) 9420 0300 f (08) 9474 9900 w www.perthenergy.com.au
unit 3, 77 mill point road, south perth, wa 6151 acn 087 386 445

Moreover, where the out-of-service generator is owned by a generator-retailer, the Participant may gain a significant benefit in that it pays nothing towards the SRC while its competitor retailers carry the full cost. It is quite inequitable for such a benefit to accrue to the Participant that has caused the capacity shortfall.

Comparison with the cost allocation for surplus capacity

Where the IMO has secured surplus capacity, beyond the Reserve Capacity Target, the cost of this excess is spread across all Market Participants through the Shared Reserve Capacity Cost. The Excess Capacity Adjustment, through which the impact of excess capacity is taken into account if there is no auction, also ensures that the impact of excess capacity is spread across all Market Generators.

Perth Energy considers that the SRC costs should be treated in a similar manner to the costs of surplus generation. SRC costs should be spread across all Market Customers without regard to their level of bilateral contracts.

Summary

The Market Rules relating to the allocation of SRC presently provide an incentive for Market Participants to bilaterally trade Capacity Credits. This may be perceived to be an advantage, however, the allocation of SRC costs to only that proportion of load that is not bilaterally contracted imposes significant risks. The costs of SRC are potentially so high as to place smaller Market Participants at extreme financial risk. This is totally inappropriate, particularly when the Participant that has caused the capacity shortfall situation to occur may face no SRC costs at all.

Perth Energy strongly supports the proposed change to the Market Rules whereby SRC costs are spread across all Market Customers.

Yours faithfully,

Patrick Peake
General Manager, Wholesale
Perth Energy