

Independent Market Operator

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For enquiries or further information, email imo@imowa.com.au or alternatively contact the IMO at

PO Box 7096
Cloisters Square
Perth WA 6850

Market Outcomes for 2006/07

It is early days in electricity trading within the South West Interconnected System but already positive benefits from energy trading are emerging.

Early trends in the operation of the electricity trading market reflect the context of market start, seasonal factors and the development of a deeper understanding by Market Participants as to how the market works. However, more recently market trends appear to reflect the emergence of trading strategies and Market Participants establishing their positions in the market.

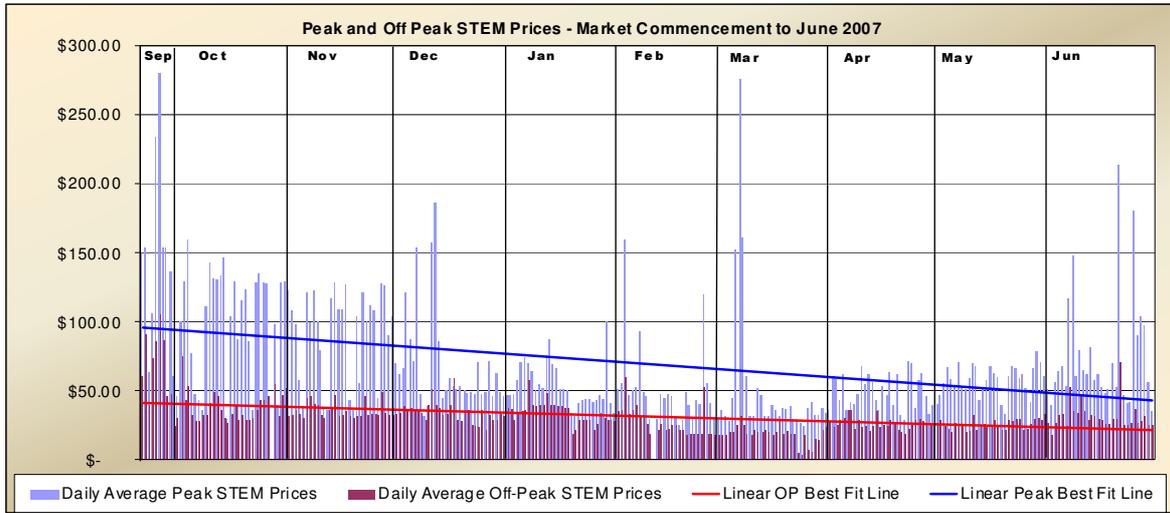
External influences such as fuel restrictions, weather and load conditions along with generator availability, fuel supply and bidding strategies continue to have a pronounced effect on market trends.

Energy prices in the STEM have been effective in signalling the cost in the market:

- For the first three months of market operation, the STEM prices were high due to fuel restrictions and low levels of generator availability
- As generator availability increased and fuel restrictions were lifted, STEM prices dropped accordingly
- There were some brief periods of high prices around February and March due to the extreme demands at this time
- More recently, prices have risen slightly as a result of increased plant outages due to maintenance, and further fuel restrictions
- As expected, high prices have been most apparent in the peak periods

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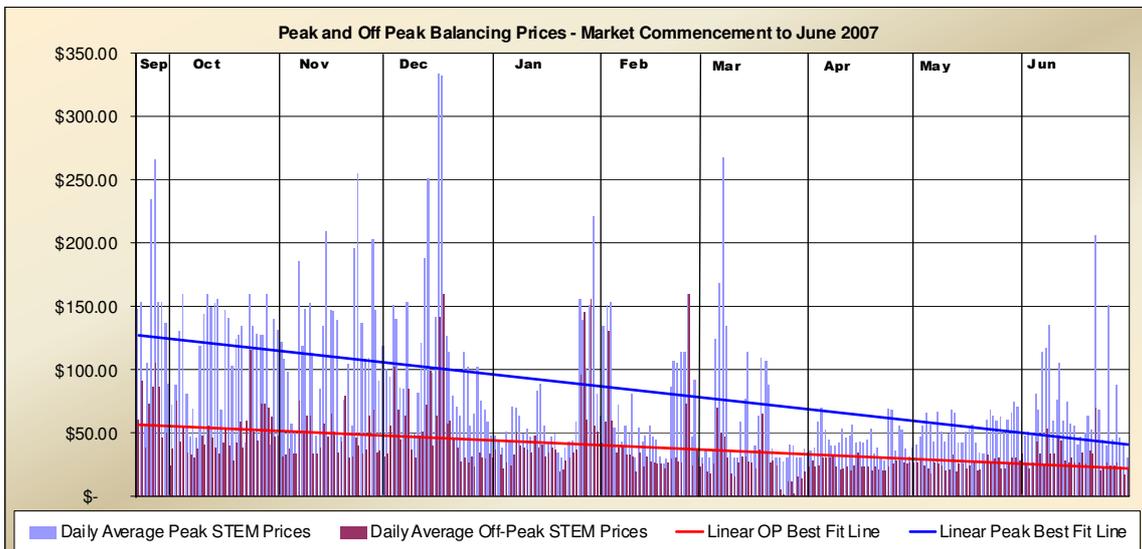
The diagram below shows the peak and off-peak STEM prices since commencement of the market.



Prices in the balancing market have been, on average, higher than STEM prices. This is likely to reflect the initial tendency by Market Participants to 'buy' more energy in balancing than the STEM. This led to higher demand in real time than projected the day ahead, which led to the upward recalculation of balancing prices.

More recently however, Market Customers have tended to enter bilateral positions that exceed their load and then sell energy back into the balancing market. This has resulted in average balancing prices more closely matching STEM prices since March.

The peak and off-peak balancing prices since market commencement are shown in the diagram below.

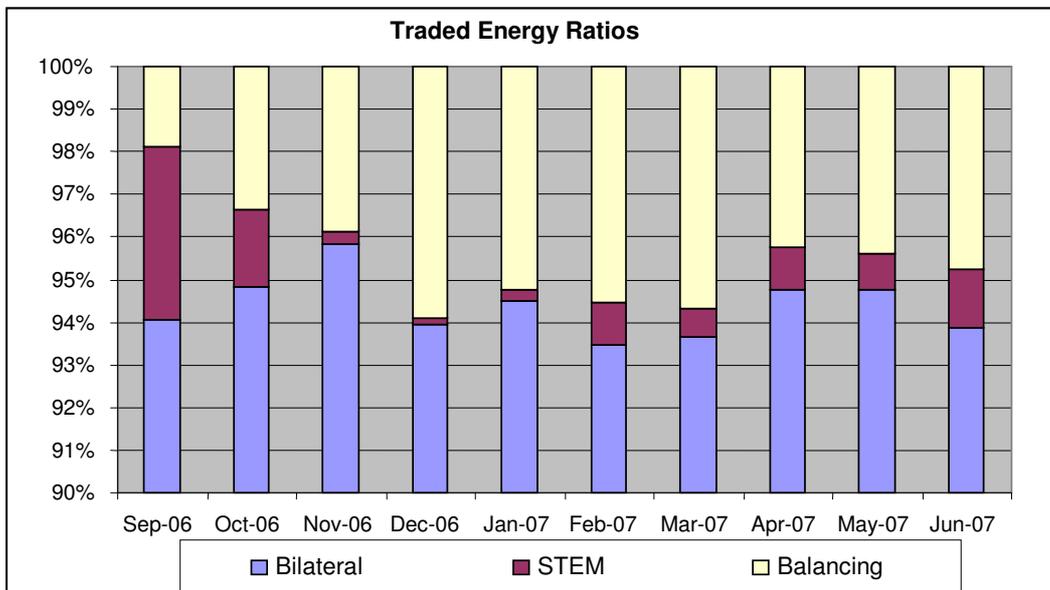


It must be recognised that it is very early days in the market and long-term trends are yet to emerge. In addition, the effectiveness of the WEM is also likely to be affected currently by the dominant role of two Market Participants (Verve Energy and Synergy) and the nature of the vesting contract between them.

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However, the above data and discussion suggests that the market is providing Market Participants with a real opportunity to trade electricity and manage risk. As the vesting contract cover is reduced and further supply and retail competition emerges the STEM market is expected to become a stronger alternative to bilateral contracts.

Most electricity is being traded through bilateral contracts but, as can be seen in the diagram below a significant proportion, between 4.5% and 6.5%, is being traded in the Short Term Energy Market (STEM) and the balancing market. This is consistent with expectations prior to market start.



There was relatively strong trading activity in the STEM at the start of the market, as traders developed their strategic approach to trading. As the market progressed, STEM trades declined considerably but, towards the end of the financial year, STEM trades increased once again. A large number of these STEM trades are between generators. This suggests that the STEM is being used by generators to access lower cost plant, a positive benefit from the establishment of the market.

The Market, therefore, is providing Market participants with a real opportunity to trade electricity and manage risk. For more information see Wholesale Electricity Market, Electricity Trading 2006/07 on the IMO website.

Capacity Locked in for 2009/2010

During August 2007, the IMO successfully completed the assignment of capacity credits to generation and demand side management (DSM) facilities for 2009/10. Approximately 5,000 MW of Capacity Credits were assigned to generation facilities with a further 100 MW assigned to DSM ensuring that the Reserve Capacity Target for the period from October 2009 through to October 2010 has been met.

Nearly 600 MW of this capacity will be new, indicating the confidence that developers have in the reserve capacity mechanism. This new plant is a balance of coal-fired, gas-fired and renewable generation and includes capacity that is designed to operate in both base load and peaking roles. While a range of generator sizes is emerging, it is also encouraging to see ongoing development of smaller facilities.

The total number of capacity credits assigned, 5,136 MW, exceeds the Reserve Capacity Target by 527 MW. The Reserve Capacity Price for 2009/10 has been determined through the administrative process to be \$108,458.57 per MW per year. As well as increasing the level of security in the power system, this extra capacity will strengthen the competitive pressure within the energy market.

Strong Interest in Market Training Courses

Nearly 50 people have so far attended the latest round of market training courses provided by the IMO. The two day courses cover key aspects of the market including participant and facility registration, the capacity and energy markets and settlement. A simple interactive model allows the instructors to walk participants through the main market processes.

Although the course is primarily aimed at people who will be directly operating in the market, it has also proved to be popular with other key stakeholders. The IMO is planning to offer further courses on a regular basis and expects to seek enrolments for the next course in November. For those who are not able to attend a course in Perth, or would like information before the next course, copies of the training material are available for downloading on the IMO website.

IMO Seeking Comments on Review of Forecast Process and Reliability Criteria

The IMO is seeking stakeholder comments on several important planning documents that it has recently published on its website. The IMO is required by the Market Rules to undertake regular reviews of the Planning Criteria which is used to determine the amount of capacity that should be provided within the SWIS. To assist in this process, the IMO established an Advisory Committee comprising representatives of industry and government. It also retained CRA International (CRAI) to assess the appropriateness of the existing reliability criterion.

CRAI examined a range of factors including the criteria used in other power systems, the costs and benefits of making any changes to the SWIS criterion, and the potential impact of changes in generator reliability over time. CRAI concluded that the existing criterion provides an appropriate level of reserve as measured in terms of megawatts. However, CRAI recommend that this criterion should be “future proofed” by linking the size of the reserve margin to the forecast level of maximum demand.

The IMO has prepared a Draft Report entitled “Review of the SWIS Reliability Criteria” which summarises the main points of the CRAI report and makes formal recommendations. This Draft Report, along with the CRAI Report, is available on the IMO website and stakeholders are invited to make submissions by Friday, 5 October. The IMO will then prepare a Final Report, taking account of submissions, and will commence making any required changes to the Market Rules.

A second, parallel study has reviewed the process by which the forecasts of maximum electricity demand are developed. A Draft Report entitled “Review of the SWIS Forecasting Process” has been prepared which examines the internal processes of the IMO with particular emphasis on the impact of the Wholesale Electricity Market System on data gathering. This Draft Report is available on the IMO website and interested parties are invited to make submissions to the IMO in respect to this report, again by Friday 5 October.

The electricity forecasts are prepared by the National Institute of Economic and Industry Research (NIEIR). In undertaking its review, the IMO did not examine NIEIR’s processes in detail but drew on a review that was undertaken for the National Electricity Market Management Company. (This is available on the NEMMCO website at www.nemmco.com.au). However, the IMO considers that it is appropriate that an independent review be undertaken of NIEIR’s processes in respect to their forecasting for the SWIS. The IMO has now issued a Request for Tenders for this independent review.

Comments Sought on Energy Price Limit Report

In keeping with the Market Objective of facilitating economically efficient pricing of electricity, limits are placed on some of the prices that Market Participants can offer within the Wholesale Electricity Market. To ensure that these price limits remain appropriate, the Market Rules require the IMO to review the energy price limits each year.

To undertake the 2007 review, which covers both the price drivers and the underlying methodology, the IMO retained consultant McLennan Magasanik Associates (MMA). The IMO, with the assistance of MMA has completed its draft report and this has been posted to the IMO website. Interested parties are now invited to make submissions in respect to the proposed revised values.

In its review, MMA noted the significant recent increases in gas purchase and transport costs, and the draft report proposes a value of \$206 per MWh for the Maximum STEM Price. The report also proposes a value of \$498 per MWh for the Alternative Maximum STEM Price. This price is adjusted on a monthly basis in line with changes in distillate prices.

The review recommends a methodology to address the issues of cost uncertainty and risk margins. The recommended approach is to set Energy Price Limits at levels that exceed the short run marginal costs of a peaking plant with an acceptable probability. MMA's analysis also explicitly includes start-up costs within the calculation. This is seen as important so as to not unduly inhibit new entry of peaking plant.

Submissions may address any issues that interested parties consider to be relevant to this review and need not be confined to the issues identified in the draft report. The IMO draft report, along with information about how to make a submission, is provided on the IMO website. The closing date for submissions is October 10.

Rule Change Processes Underway

As Market Participants and the IMO gain more experience in the operation of the market, a number of proposals for making refinements to the Market Rules are being considered. Three changes have recently been implemented which relate to:

- Verve Energy being required to seek approval from System Management prior to synchronisation of a generator.
- An anomaly within the Reserve Capacity Shortfall Calculations.
- Individual Reserve Capacity Requirements of New Customers.

The IMO is currently preparing Final Reports for five proposals which relate to:

- The impact of Downward Dispatch Instructions on Intermittent Generators.
- System Management's treatment of Demand Side Management in outage planning and in preparation of the Projected Assessment of System Adequacy.
- Registration exemptions for small generators.
- The provision of information to the IMO by System Management.
- Outage notification by facilities that have Reserve Capacity that does not currently hold capacity credits.

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Three proposals for rule changes are open until 25 September 2007. These relate to:

- Increasing the flexibility of timelines for the STEM.
- Allowing the IMO discretion as to whether it issues a warning in respect to an alleged rule breach.
- The calculation of Reserve Capacity Refunds.

Further information on all Rule Change proposals is available from the IMO website.