



Independent Market Operator

Rule Change Notice

**Title: Treatment of Negative
MCAP on the settlement
of Ancillary Services**

Ref: RC_2009_21

Standard Rule Change Process

Date: 12 June 2009

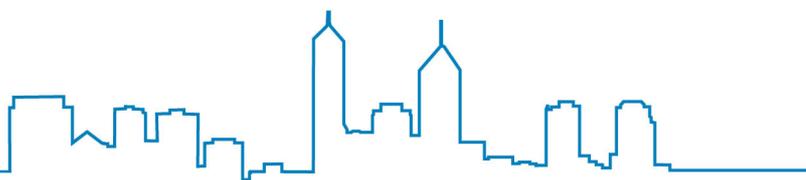
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DOCUMENT DETAILS

IMO Notice No.: RC_2009_21
Report Title: Rule Change Notice: Treatment of Negative MCAP on the settlement of Ancillary Services
Release Status: Public
Confidentiality Status: Public domain
Published in accordance with Market Rule 2.5.7

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1. THE RULE CHANGE PROPOSAL

1.1. The Submission

On 11 June 2009 Verve Energy submitted a Rule Change Proposal regarding an amendment to clause 9.9.2 of the Wholesale Electricity Market Rules (Market Rules).

This Rule Change Notice is published according to Market Rule 2.5.7, which requires the Independent Market Operator (IMO) to publish a notice within 7 Business Days of receiving a Rule Change Proposal.

1.1.1 Submission details

| | |
|---------------------------------|--|
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| Date submitted: | 11 June 2009 |
| Urgency: | Standard Rule Change Process |
| Change Proposal title: | Treatment of Negative MCAP on the settlement of Ancillary Services |
| Market Rule(s) affected: | Clause 9.9.2 |

1.2. Details of the Proposal

Background

In its proposal Verve Energy notes that Ancillary Services are used to guarantee the safe, secure and reliable production of electricity on the South West interconnected system (SWIS) by ensuring the system can adequately respond to real time changes in load and generation under a range of scenarios. Ancillary Services are used to control key technical characteristics of the power system such as frequency and voltage. In particular Ancillary Services:

- help maintain Power System Security (ability of SWIS to deliver energy within reliability standards);
- help maintain Power System Reliability (ability of the SWIS to withstand sudden disturbances including restoration in the case of blackout);
- facilitate orderly trading in electricity; and
- ensure that electricity supplies are of acceptable quality.

Ancillary Services are required to support the Wholesale Electricity Market (WEM) but are not traded as part of the WEM. System Management is required to procure adequate quantities of

these services, either from Electricity Generation Corporation (Verve Energy) resources (the default option) or on a contestable basis from independent providers (if they provide a least cost option to Verve's Facilities).

Verve Energy also notes that System Management will budget the cost of procuring Ancillary Services, where budgeted costs must be in accordance with those approved by the Economic Regulation Authority. However, System Management will not fund Ancillary Services. Rather, the IMO recovers the costs of the Ancillary Services from Market Participants through the WEM settlement systems, and will use the revenue received to fund Ancillary Services provided by Verve Energy and any contracted Ancillary Service providers.

In its submission Verve Energy notes that the Market Rules provide for the settlement of Ancillary Services based on an availability payment, whereas energy is settled separately. Clause 9.9 of the Market Rules outlines the Ancillary Service settlement calculations for a Trading Month. In particular, clause 9.9.2 outlines the availability payment arrangements for the provision of Ancillary Services by Verve Energy.

The calculations use the value of the Marginal Cost Administrative Price (MCAP) as the price input and the quantity of Ancillary Services provided to calculate the total availability cost for the supply of Ancillary Services. Payments to other Market Generators for the supply of Ancillary Services are determined through arrangements directly between System Management and the provider.

Issue

Verve Energy submits that the provision of Ancillary Services such as load following and spinning reserve imposes additional costs on the service provider including increased plant maintenance, out-of-merit plant dispatch and lost energy sales opportunities. The costs incurred will vary and it is foreseeable that they could tend towards zero on occasions. However it is highly improbable that cost savings would result from providing the services.

Verve Energy notes that their main concern is that the equations specified under clause 9.9.2 can result in a negative availability cost payment when MCAP prices are less than zero. This would result in Verve Energy paying to supply Ancillary Services to the market whilst having no realistic expectation of having offsetting cost savings. Thus Verve Energy would be subsidising the cost of service to the market. This is clearly an inequitable and economically inefficient outcome. In addition, the potential requirement to supply below cost acts as a disincentive to supply and may discourage independent providers from offering competitive Ancillary Services.

Proposal

Verve Energy proposes that clause 9.9.2 of the Market Rules be amended to incorporate a price floor on the value of MCAP used in the Ancillary Service availability cost calculations, to address this issue. Verve Energy proposes that this price floor be set at \$0/MWh.

Verve Energy contends that adopting a price floor of zero for Ancillary Services would:

- Ensure Verve Energy is not required to pay to supply Ancillary Services when MCAP is negative;

- Better reflect the cost of provision of Ancillary Services by Verve Energy to the market;
- Reduce disincentives to supply; and;
- Represent a balance between demonstrating the value of the services to the market and the potential for over recovery of costs if a higher priced floor, say \$10/MWh, was adopted.;

In its submission Verve additionally notes that it considers the proposed amendments to represent a temporary fix in the absence of a better mechanism. Verve Energy comments that they expect the advent of that better mechanism in the future.

1.3. The Proposal and the Wholesale Market Objectives

- a) *to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;*

Verve Energy contends that the proposed Amending Rules will better achieve market objective (a) by making certain the system can adequately respond to real time changes in load and generation under a range of scenarios. In particular, the proposed changes will ensure the safe and reliable production of electricity can be maintained by incentivising supply of Ancillary Services. This will be achieved by better reflecting the true value of Ancillary Services to the market when MCAP is negative in the payment calculations.

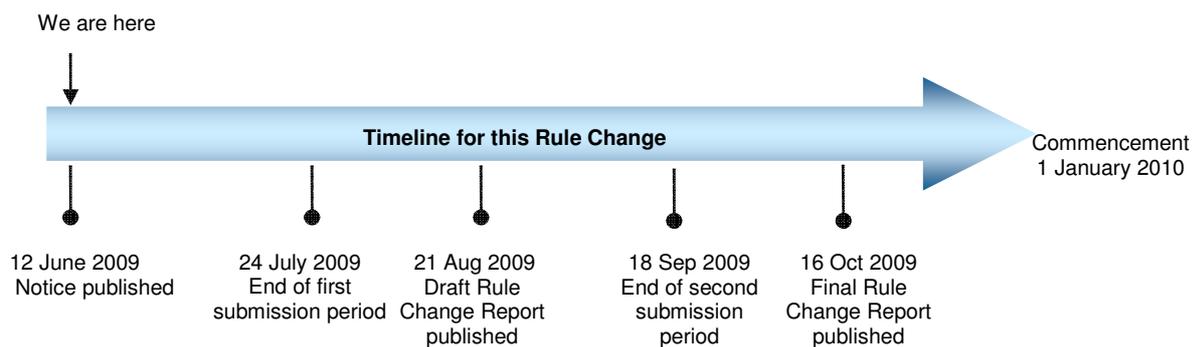
Verve Energy considers that the proposed Amending Rules are consistent with the remaining Market Objectives.

2. WHETHER THE PROPOSAL WILL BE PROGRESSED FURTHER

The IMO has decided to proceed with this proposal on the basis that the IMO's preliminary assessment indicated that the proposal is consistent with the Wholesale Market Objectives.

The IMO has decided to process this Rule Change Proposal using the Standard Rule Change Process, described in section 2.7 of the Market Rules.

The projected timelines for processing this proposal are:



Please note that the Commencement Date is provisional and may be subject to change in the Final Rule Change Report.

3. CALL FOR SUBMISSIONS

The IMO is seeking submissions regarding this proposal. The submission period is 30 Business Days from the publication date of this Rule Change Notice. Submissions must be delivered to the IMO by the close of business on **Friday 24 July 2009**.

The IMO prefers to receive submissions by email to **marketadmin@imowa.com.au** using the submission form available on the IMO website:

http://www.imowa.com.au/10_5_1_MarketRulesChangeSummary.html

Submissions may also be sent to the IMO by fax or post, addressed to:

Independent Market Operator
 Attn: Manager Market Administration and System Capacity
 PO Box 7096
 Cloisters Square, Perth, WA 6850

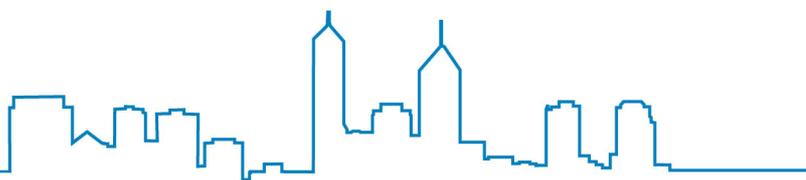
Fax: (08) 9254 4399

4. PROPOSED AMENDING RULES

Verve Energy proposes the following amendments to the Market Rules (~~deleted text~~, added text):

9.9.2. The following terms related to Ancillary Service availability costs:

- (a) the total availability cost for Trading Month m:



$$\begin{aligned}
\text{Availability_Cost}(m) = & \\
& 0.5 \times (\text{Margin_Peak}(m) \times \text{Sum}(d \in D, t \in \text{Peak}, \text{MCAP}(d, t) \\
& \times (\text{Capacity_R_Peak}(m) - \text{Sum}(i \in I, \text{ASP_SRQ}(i, t)))))) \\
& + 0.5 \times (\text{Margin_Off-Peak}(m) \times \text{Sum}(d \in D, t \in \text{Off-Peak}, \text{MCAP}(d, t) \\
& \times (\text{Capacity_R_Off-Peak}(m) - \text{Sum}(i \in I, \text{ASP_SRQ}(i, t)))))) \\
& + \text{Sum}(i \in I, \text{ASP_SRPayment}(i, m)) \\
& + \text{Sum}(i \in I, \text{ASP_LFPayment}(i, m))
\end{aligned}$$

- (b) the Spinning Reserve Cost Share for Market Participant p, which is a Market Generator, for Trading Month m:

$$\begin{aligned}
\text{Reserve_Cost_Share}(p, m) = & \\
& 0.5 \times (\text{Margin_Peak}(m) \times \text{Sum}(d \in D, t \in \text{Peak}, \text{MCAP}(d, t) \\
& \times \text{Reserve_Share}(p, t) \\
& \times (\text{Capacity_R_Peak}(m) - \text{Sum}(i \in I, \text{ASP_SRQ}(i, t)) - 0.5 \text{LFR}(m)))) \\
& + 0.5 \times (\text{Margin_Off-Peak}(m) \times \text{Sum}(d \in D, t \in \text{Off-Peak}, \text{MCAP}(d, t) \\
& \times \text{Reserve_Share}(p, t) \\
& \times (\text{Capacity_R_Off-Peak}(m) - \text{Sum}(i \in I, \text{ASP_SRQ}(i, t)) \\
& - 0.5 \times \text{LFR}(m)))) \\
& + \text{Sum}(t \in \text{Peak and Off_Peak}, \text{Reserve_Share}(p, t) \\
& \times \text{Sum}(i \in I, \text{ASP_SRPayment}(i, m) / \text{TITM}))
\end{aligned}$$

- (c) the total Spinning Reserve Availability Cost for Trading Month m:

$$\begin{aligned}
\text{Availability_Cost_R}(m) = & \\
& \text{Sum}(p \in P, \text{Reserve_Cost_Share}(p, m))
\end{aligned}$$

- (d) the total Load Following Availability Cost for Trading Month m:

$$\begin{aligned}
\text{Availability_Cost_LF}(m) = & \\
& \text{Availability_Cost}(m) - \text{Availability_Cost_R}(m)
\end{aligned}$$

Where

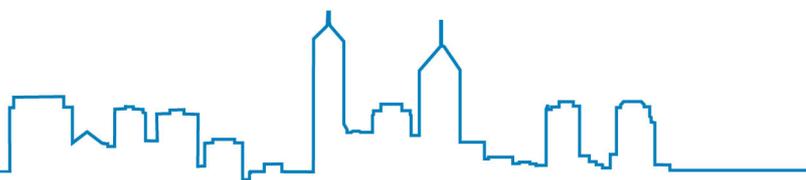
ASP_SRQ(i,t) is the quantity of Spinning Reserve provided by Ancillary Service Provider i in Trading Interval t (this being one of the quantities referred to in clause 9.9.3);

ASP_SRPayment(i,m) is defined in clause 9.9.3;

ASP_LFPayment(i,m) is defined in clause 9.9.3;

TITM is the number of Trading Intervals in the Trading Month (excluding any Trading Intervals prior to Energy Market Commencement);

Reserve_Share(p,t) is the share of the Spinning Reserve service payment costs allocated to Market Participant p in Trading Interval t, where this is to be determined by the IMO using the methodology described in clause 3.14.2;



Margin_Peak(m) is the reserve availability payment margin applying for Peak Trading Intervals for Trading Month m as specified by the IMO under clause 3.22.1(c);

Margin_Off-Peak(m) is the reserve availability payment margin applying for Off-Peak Trading Intervals for Trading Month m as specified by the IMO under clause 3.22.1(d);

Capacity_R_Peak(m) is the capacity necessary to cover the Ancillary Services Requirement for Spinning Reserve for Peak Trading Intervals for Trading Month m as specified by the IMO under clause 3.22.1(e);

Capacity_R_Off-Peak(m) is the capacity necessary to cover the Ancillary Services Requirement for Spinning Reserve for Off-Peak Trading Intervals for Trading Month m as specified by the IMO under clause 3.22.1(f);

LFR(m) is the capacity necessary to cover the Ancillary Services Requirement for Load Following for Trading Month m as specified by the IMO under clause 3.22.1(fA);

MCAP(d,t) has the meaning given in clause 9.8.1 and = 0 if MCAP(d,t) < 0;

Peak denotes the set of Trading Intervals occurring during Peak Trading Intervals, where “t” refers to a Trading Interval during a Trading Day;

Off-Peak denotes the set of Trading Intervals occurring during Off-Peak Trading Intervals, where “t” refers to a Trading Interval during a Trading Day; and

D denotes the set of Trading Days within Trading Month m, where “d” is used to refer to a member of that set.

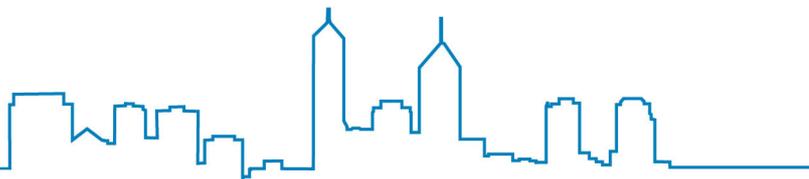
5. ABOUT RULE CHANGE PROPOSALS

Market Rule 2.5.1 of the Market Rules provides that any person (including the IMO) may make a Rule Change Proposal by completing a Rule Change Proposal Form and submit this to the IMO.

The IMO will assess the proposal and, within 5 Business Days of receiving the proposal form, will notify the proponent whether the proposal will be progressed further.

In order for the proposal to be progressed the change proposal must explain how it will enable the Market Rules to better contribute to the achievement of the Wholesale Market Objectives. The market objectives are:

- (a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;



- (b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors;
- (c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions;
- (d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system; and
- (e) to encourage the taking of measures to manage the amount of electricity used and when it is used.

A Rule Change Proposal can be processed using a Standard Rule Change Process or a Fast Track Rule Change Process. The standard process involves a combined 10 weeks public submission period, while the fast track process involves the IMO consulting with Rule Participants who either advise the IMO that they wish to be consulted or the IMO considers have an interest in the change.