

Call for Submissions
Allowable Revenue of System
Management for Review Period
1 July 2007 to 30 June 2010

21 December 2006

Economic Regulation Authority



WESTERN AUSTRALIA

A full copy of this document is available from the Economic Regulation Authority web site at www.era.wa.gov.au.

For further information, contact:

Economic Regulation Authority
Perth, Western Australia
Phone: (08) 9213 1900

© Economic Regulation Authority 2006

The copying of this document in whole or part for non-commercial purposes is permitted provided that appropriate acknowledgment is made of the Economic Regulation Authority and the State of Western Australia. Any other copying of this document is not permitted without the express written consent of the Authority.

Contents

Introduction	4
Background	4
Role of the Authority	4
The Determination Process	5
Issues for Consideration	6
Prudence and Efficiency	6
Appropriateness of Labour Cost Allocation	6
Appropriateness of Functional Cost and Legal Cost	7
Appropriateness of Self-Insurance Costs	7
Depreciation Method of Phase 1 IT Cost	7
Work Program and Operating Expenditures	8
Ancillary Services	8
Making a Submission	8
Confidentiality	8
Format For Submissions	9

Introduction

This paper is published pursuant to clause 2.23.3(b) of the *Wholesale Electricity Market Rules* (the **Market Rules**).

The purpose of this paper is to assist interested parties in making submissions on the Allowable Revenue Application by System Management. The issues identified in this paper are not intended to be exhaustive but to indicate a number of matters which the Economic Regulation Authority (**Authority**) has identified as potentially relevant to its assessment of System Management's cost proposal.

On 30 November 2006, System Management submitted its cost proposal to the Authority for the determination of its Allowable Revenue. The proposal is outlined in the document *System Management Allowable Revenue Application (Proposal)*. This Proposal covers the time period from 1 July 2007 to 30 June 2010 (**Review Period**).

The Proposal document is available on the Authority's web site (www.era.wa.gov.au). Printed copies of the documentation are also available for \$25.00 per set. Requests for the documents can be made to:

Mr Ignatius Chin
Assistant Director – Electricity Market Surveillance
Economic Regulation Authority
Telephone: (08) 9213 1916
Fax: (08) 9213 1999
Email: ignatius.chin@era.wa.gov.au

A notice has been posted on the Authority's web site advising that the proposed Allowable Revenue Application has been lodged with the Authority.

This notice invites submissions to be lodged with the Authority by 4:00pm (Western Daylight Saving Time) on 31 January 2007.

After considering all submissions, the Authority will determine the final Allowable Revenue of System Management for the Review Period.

Background

Role of the Authority

The Market Rules require the Authority to determine the Allowable Revenue of System Management for providing the services stated in clause 2.23.1 of the *Wholesale Electricity Market Rules*. These services include:

- a) system operation services, including all of System Management's functions and obligations under the Market Rules except the provision of Ancillary Services; and
- b) System Management's functions and obligations under the Market Rules in relation to the provision of Ancillary Services.

The Determination Process

The determination process in relation to System Management's Allowable Revenue is defined in clause 2.23.3 of the Market Rules. This process is as follows:

- System Management must submit the proposal for its costs for the Review Period.
- The Authority must undertake a public consultation process. This paper, along with the invitation for public submissions form part of the consultation process.
- The Authority must determine the Allowable Revenue by 31 March 2007.

In accordance with the Market Rules, the Authority must take the following into account when determining the Allowable Revenue of System Management:

- the Allowable Revenue must be sufficient to cover the forward looking costs of providing the services described in clause 2.23.1 of the Market Rules and performing its functions and obligations under the Market Rules in accordance with the following principles:
 - a) recurring expenditure requirements and payments are recovered in the year of the expenditure;
 - b) capital expenditures are to be recovered through the depreciation and amortisation of the assets acquired by the capital expenditure in a manner that is consistent with generally accepted accounting principles;
 - c) costs incurred by System Management that are related to market establishment, as designated by the Minister, are to be recovered over a period determined by the Minister from Energy Market Commencement; and
 - d) notwithstanding points (a), (b) and (c) above, expenditure incurred, and depreciation and amortisation charged, in relation to any Declared Market Project are to be recovered over the period determined for that Declared Market Project (see clause 2.22.13 of the Market Rules for the meaning of the word Declared Market Project);
- the Allowable Revenue must include only costs which would be incurred by a prudent provider of the services described in clause 2.23.1 of the Market Rules, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering the services described in clause 2.23.1 in accordance with the Market Rules, while effectively promoting the Wholesale Market Objectives;
- where possible, the Authority should benchmark the Allowable Revenue against the costs of providing similar services in other jurisdictions;
- the determination of the Allowable Revenue of Ancillary Service provision must take into account the payment structure set out in clause 3.13 of the Market Rules, and the Authority must determine values for:
 - a) the reserve availability payment margin applying for Peak Trading Intervals, Margin_Peak, which must take account of:
 - i. the margin the Electricity Generation Corporation could reasonably have been expected to earn on energy sales foregone due to the supply of Spinning Reserve during Peak Trading Intervals;
 - ii. the loss in efficiency of the Electricity Generation Corporation Registered Facilities that System Management has scheduled to

provide Spinning Reserve during Peak Trading Intervals that could reasonably be expected due to the scheduling of those reserves;

- b) the reserve availability payment margin applying for Off-Peak Trading Intervals, Margin_Off-Peak, which must take account of:
 - i. the margin the Electricity Generation Corporation could reasonably have been expected to earn on energy sales foregone due to the supply of Spinning Reserve during Off-Peak Trading Intervals;
 - ii. the loss in efficiency of the Electricity Generation Corporation Registered Facilities that System Management has scheduled to provide Spinning Reserve during Off-Peak Trading Intervals that could reasonably be expected due to the scheduling of those reserves;
- c) Cost_LRD, which must cover the costs for providing the Load Rejection Reserve, System Restart, and Dispatch Support Ancillary Services.
- the determination of the Allowable Revenue of Ancillary Service provision must take into account Ancillary Service Contracts that System Management has entered into.

Issues for Consideration

The Authority invites comment on the costs proposed by System Management. In particular, comment is invited on the following:

- Prudence and efficiency
- Appropriateness of labour cost allocation
- Appropriateness of functional cost and legal cost
- Self Insurance
- Depreciation Method of Phase 1 IT Cost
- Work Program
- Operating Expenditure
- Ancillary Services Costs
- Benchmarking
- Other Issues

Prudence and Efficiency

The Authority invites comment on whether the costs proposed reflect those of a service provider acting efficiently in accordance with good electricity industry practice as provided for by clause 2.23.12(b) of the Market Rules.

Appropriateness of Labour Cost Allocation

System Management considers 19.1 FTEs are required to perform its role under the Market Rules. The labour cost requirements are illustrated in Table 2 of the Proposal

which divides the cost into several categories: Management, Planning and Market Operations, System Control, Network Operations and SCADA.

The Authority invites comment on the appropriateness of the scope and allocation of labour cost requirements.

In addition, the Authority seeks comment on the labour on-costs discussed in section 5.2.2 of the Proposal.

Appropriateness of Functional Cost and Legal Cost

The Authority invites comment on the appropriateness of the functional and legal costs allocation as proposed in sections 5.3 and 5.4 of the Proposal.

Functional costs relate to consultant expenditure for advice, contractor engagement for specific activities and other specific activities. The Authority seeks comment on the types of services System Management is likely to need hence the appropriateness of cost allocation.

The Authority acknowledges that legal expenses are difficult to forecast. The Authority seeks comment on the circumstances where System Management will require legal services hence the appropriateness of the proposed legal expenses.

Appropriateness of Self-Insurance Costs

The Authority invites comment on the appropriateness of the proposed self-insurance arrangement and its cost as discussed in section 5.5 of the Proposal.

System Management proposes to self-insure as it is not yet able to obtain suitable insurance coverage. The self-insurance cost has been proposed at \$500,000 per annum over the three year Review Period.

The Authority seeks comment on the appropriateness of the proposed self-insurance arrangement. The Authority invites comment on suitable alternative arrangements to mitigate the risk exposure of System Management.

In addition, the Authority invites comment on the adequacy of the self-insurance cost proposed.

The Authority notes that the total risk exposure of System Management has not been quantified in the Proposal.

Depreciation Method of Phase 1 IT Cost

The Authority invites comment on the depreciation calculation methodology to recover the Phase 1 capital cost as discussed in section 6.2 of the Proposal.

The Phase 1 capital costs relate to the market commencement and amount to \$2,500,000. The depreciation and recovery of this amount was to be over five years as determined by the Minister pursuant to clause 2.23.12(a)(iii) of the Market Rules.

In its Proposal, System Management seeks to revise the approved depreciation calculation methodology where it seeks to recover the market establishment costs over a period of two and a half years, rather than the five years originally approved by the Minister. System Management seeks the revision to the methodology to align to the requirement of “generally accepted accounting principles” pursuant to clause 2.23.12(a)(ii) of the Market Rules.

The Authority seeks comment on the proposed revision to the depreciation calculation method referred to above.

Work Program and Operating Expenditures

The Authority seeks comment on the work program and operating expenditures proposed by System Management in sections 6.3, 6.4, 6.5 and 6.6 of the Proposal.

The Authority seeks comment as to whether the proposed work program is consistent with that of a prudent provider of system operations services.

Ancillary Services

The Authority seeks comment on System Management’s functions and obligations under the Market Rules in relation to the provision of the Ancillary Services.

Benchmarking

The Authority invites comment on the benchmarking of System Management’s costs as set out in the Proposal.

Making a Submission

Submissions are invited from all interested parties on System Management’s Allowable Revenue Application which must be received by 4:00pm (Western Daylight Saving Time) on 31 January 2007.

Interested parties should note that the proposed timetable for this determination process is required to be completed by 31 March 2007.

Confidentiality

In general, all submissions from interested parties will be treated as in the public domain and placed on the Authority’s web site. The receipt and publication of any submission lodged for the purposes of this determination process shall not be taken as indicating that the Authority has formed an opinion as to whether or not any particular submission contains any information of a confidential nature.

Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission in respect of which confidentiality is claimed.

Format For Submissions

Submissions with comments on System Management's Allowable Revenue Application should be in both written and electronic form and addressed to:

Mr Ignatius Chin
Assistant Director – Electricity Market Surveillance
Economic Regulation Authority
Level 6 Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

Email: ignatius.chin@era.wa.gov.au