



31 January 2011

Mr Chris Brown
Acting Assistant Director, Electricity Market Surveillance
Economic Regulation Authority
Po Box 8469, Perth BC WA 6849

Dear Chris,

Submission on Proposed Ancillary Service Margin Values and System Restart Costs

Thank you for the opportunity to comment on the submission from the Independent Market Operator (IMO) to the Economic Regulation Authority (Authority) proposing values for the parameters Margin Peak and Margin Off-Peak (Margin Values) and revised 'R' values of the cost LR parameter. ERM Power's (ERM) comments are provided below.

Process:

The ancillary service calculations are a complex part of the Market Rules and as such wider consultation would be of benefit to allow participants to gain a better understanding of the methodology and assumptions made. In particular assumptions have been made about facilities without consultation with the Market Participant to confirm the validity of such. As per Table 1 below, there has been an almost 250% increase in the weighted average Margin Values since Market start. Given these material increases on a service with availability cost to market of \$35M, it is reasonable to expect Market Participants to want more involvement and better understanding of the process than currently provided. Market Participants have very little transparency of how the ancillary service costs are determined both in terms of the outputs of the Plexos model used in determining the Margin Values and also operationally regarding spinning reserve costs imposed on various levels of plant dispatch. With this lack of transparency and the service's material costs, the Authority must as a minimum require that a review be carried out comparing the Plexos model against historical actual dispatch volumes, reserve margins and availability costs.

Table 1: Actual and Proposed Margin Values

Margin Values	Sep-06 to Jul-10	Jul-10 to Jul-11	Proposed Jul-11 to Jul-12
Margin Peak	15%	30%	44%
Margin Off-Peak	12%	103%	53%
Calculated Weighted Average	13.8%	59.17%	47.6%
Peak % Change (Market Start)		100%	193%
Off-Peak % Change (Market Start)		758%	342%
Weighted Average % Change (Market Start)		329%	245%

It is noted that the calculations for the Margin Values have been based on only Verve facilities providing the service which provides an inefficient outcome, however, follows the restrictions of the current Market Rules. During the recent design reviews of the Balancing Mechanism, Independent Power Producers were clear in their disapproval of a monopoly supplier receiving cost recovery of an inefficient service. Under the current

determination of the Margin Values, providing cost recovery to Verve will provide little incentive for Government owned entities to move towards a competitive market. An ancillary services market must be introduced to allow the market to competitively determine a price as opposed to a complex theoretical model. ERM encourages the Authority to push for a competitive market process.

ERM notes that no supporting information has been provided for the determination of the revised 'R' values and as such it is not possible to verify the sensibility of the proposed System Restart costs. ERM requests that further detail be provided to Market Participants.

Determination of Proposed Values:

Regarding the methodology outlined in the SKM/MMA Final Report to IMO please consider the following comments/questions:

1/ SRMC (Table 4-4): The SRMC figures for gas facilities appear to include the Take or Pay reservation charge component of the gas transport tariffs. As this is a fixed cost it should not be included in the SRMC and if included will result in a material over estimation of the System Marginal Price (SMP). ERM requests that the Authority clarifies the use of this fixed cost component in its evaluation.

2/ Availability Cost = GenCost_Res – GenCost_NRP + (GenQ_NRP – GenQ_Res)*SMP:

- The first part of this equation appears to capture the efficiency costs of providing spinning reserve. Whilst a GT operating at 50% load is incurring heat rate degradation, in total the unit is consuming less gas. Therefore the spinning reserve service should not be the factor defining the T1 contracted capacity. As 80% of the T1 tariff is a fixed sunk cost incurred for reasons other than spinning reserve, ERM requests that the Authority clarifies that it has not been used in the calculation of GenCost.
- The first part of this equation appears to capture the additional start-up costs incurred for providing unit commitment. Typically GT minor and major maintenance cycles are based on a start based or run hour (EOH) based maintenance regime. ERM requests that the Authority clarifies that the calculation of maintenance costs has not included the double counting of both start and run hour based maintenance.
- The second part of this equation appears to calculate the margin Verve Energy could reasonably have been expected to earn on the energy sales foregone (MR 3.13.3A(a)(i)(1) and MR 3.13.3A(a)(ii)(1)). It is unclear that the equation achieves this as the calculation appears to be a volume difference * system marginal price (MCAP) which achieves the outcome of calculating lost revenue and not lost profit margin. ERM requests that Authority clarifies the calculation of profit margin foregone.

Should you require any further information or wish to discuss the issues raised then please don't hesitate to contact me on (08) 94811100.

Yours sincerely,



Andrew Sutherland
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