

# Determination of the Ancillary Service Margin\_Peak and Margin\_Off-Peak Parameters

31 March 2011

Economic Regulation Authority

 WESTERN AUSTRALIA



## Contents

<b>DETERMINATION</b>	<b>1</b>
<b>REASONS</b>	<b>1</b>
Background	1
Public Consultation Process	2
Assessment	2
<b>CONCLUSION</b>	<b>3</b>



## DETERMINATION

1. Pursuant to clause 3.13.3A of the *Wholesale Electricity Market Amending Rules (Market Rules)*, the Economic Regulation Authority (**Authority**) has determined the Margin\_Peak and Margin\_Off-Peak parameters to be used in the settlement calculation are 25 per cent for Margin\_Peak and 43 per cent for Margin\_Off-Peak, effective from 1 July 2011.

## REASONS

### Background

2. Under clause 3.13.3A of the Market Rules, the Authority must determine the values for the Margin\_Peak and Margin\_Off-Peak parameters for each financial year by 31 March prior to the start of that financial year. In making the determination, the Authority is required to undertake a public consultation process and take into account:
  - the Wholesale Market Objectives; and
  - the proposal submitted by the Independent Market Operator (**IMO**).
3. The Market Rules set out the factors that the IMO must take into account in its proposal for the values of the Margin\_Peak and Margin\_Off-Peak parameters:<sup>1</sup>
  - the margin the Electricity Generation Corporation (Verve Energy) could reasonably have been expected to earn on energy sales foregone due to the supply of Spinning Reserve; and
  - the loss in efficiency of Verve Energy's Registered Facilities that could reasonably be expected due to the scheduling of those reserves by System Management.
4. On 30 November 2010, the IMO submitted to the Authority its proposed values for the Margin\_Peak and Margin\_Off-Peak parameters for the 2011/12 financial year, accompanied by a report prepared by Sinclair Knight Merz / McLennan Magasanik and Associates. SKM MMA was engaged by the IMO to carry out an independent assessment and modelling of the margin values. The IMO's submission is available on the Authority's website.<sup>2</sup>
5. The proposed margin values by the IMO were 44 per cent for Margin\_Peak and 53 per cent for Margin\_Off-Peak for the 2011/12 financial year. These values represented a significant change to the margin values currently used in the IMO's settlement calculation, i.e. 30 per cent for Margin\_Peak and 103 per cent for Margin\_Off-Peak.

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<sup>1</sup> The Margin\_Peak and Margin\_Off-Peak parameters are used in the Ancillary Service settlement calculations under clause 9.9.2 of the Market Rules.

<sup>2</sup> See ERA website, [Independent Market Operator – Submission under clause 3.13.3A\(a\) \(inclusive of an independent assessment by the consultant SKM MMA\)](#).

## Public Consultation Process

6. The Authority issued a Notice on 24 December 2010, inviting public submissions on the IMO's proposal. The Authority also published an Issues Paper to assist interested parties in making submissions. The period for public submissions closed on 27 January 2011.
7. Submissions were received from Alinta, Synergy, ERM Power and Griffin Power. These submissions are available on the Authority's website.<sup>3</sup>
8. The main issues raised in the public submissions include:
  - the lack of broader consultation with Market Participants in the IMO's process;
  - the fuel price assumptions, in particular the gas transport costs used for calculating short-run marginal costs;
  - perceived over-compensation to Verve Energy because the calculation formula presented in SKM MMA's report could be interpreted as foregone revenue instead of foregone margin; and
  - additional Load Following requirements associated with the commissioning of the Collgar wind farm.

## Assessment

9. The Authority has assessed the IMO's proposal against the factors set out in clause 3.13.3A of the Market Rules by taking into account:
  - the Wholesale Market Objectives;
  - whether the proposed values by the IMO reflect what Verve Energy could reasonably have been expected to earn on energy sales foregone and the loss in efficiency of Verve Energy's Registered Facilities due to the supply of Spinning Reserve; and
  - issues raised in the public submissions.
10. The Authority has considered whether the proposed values are consistent with the Wholesale Market Objectives. The Authority notes that the calculations of the margin values are based on Verve Energy's facilities solely providing the required Ancillary Services. Although it reflects the current arrangements in the Wholesale Electricity Market, it may not produce an efficient outcome. The Authority is aware of the work streams currently being undertaken by the IMO and System Management in attracting greater participation in the provision of Ancillary Services and increasing competition in this area.
11. The Authority has consulted with the IMO on the issues raised in the public submissions. As a result, a revised set of assumptions were established which took into account the comments received in the public submissions.

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<sup>3</sup> See ERA website, [Determination of the IMO and System Management Allowable Revenue and Ancillary Service Parameters](#).

12. The following changes have been made to the assumptions in the IMO's proposal:
  - some gas transport charges and gas commodity prices have been aligned with the assumptions made in the 2009 margin value review;
  - the base Load Following requirement has been revised down from 72 MW to 60 MW, and the total requirement post the commissioning of the Collgar wind farm has been changed from 100 MW to 89 MW; and
  - the amount of Spinning Reserve provided by Interruptible Loads under Ancillary Service Contracts has been reduced from 50 MW to 40 MW from 1 October 2011.
13. SKM MMA was subsequently engaged by the IMO to provide an update of the margin values based on the revised assumptions. The updated margin values provided by SKM MMA to the IMO on 28 March 2011 were 25 per cent for Margin\_Peak and 43 per cent for Margin\_Off-Peak for the 2011/12 financial year.
14. The Authority has evaluated the updated margin values provided by SKM MMA and the initial values proposed by the IMO. The Authority is of the view that the updated margin values are likely to be more reflective of the costs incurred by Verve Energy in providing the required Ancillary Services.
15. In consideration of the issues raised in the public submissions, the Authority recommends that the IMO conduct a review of the methodology and process applied by the IMO in deriving the margin values, prior to the next annual proposal due on 30 November 2011.

## CONCLUSION

16. Based on the assessment discussed above, the Authority determines that the values of the Margin\_Peak and Margin\_Off-Peak parameters for the 2011/12 financial year, being 25 per cent and 43 per cent, respectively.