

Decision on 2011 Energy Price Limits

Submitted by the Independent Market Operator

29 September 2011

Economic Regulation Authority

WESTERN AUSTRALIA

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DECISION

- 1 The Economic Regulation Authority (**Authority**) approves the revised value for the Maximum STEM Price of \$314/MWh pursuant to clause 2.26 of the Wholesale Electricity Market Amending Rules (**Market Rules**). In accordance with clause 6.20.11 of the Market Rules, the approved revised value for the Maximum STEM Price will apply with effect from the time specified in a notice to be published on the Independent Market Operator's (**IMO**) website.
- 2 The Authority approves the revised value for the Alternative Maximum STEM Price of \$533/MWh pursuant to clause 2.26 of the Market Rules. In accordance with clause 6.20.11 of the Market Rules, the approved revised value for the Alternative Maximum STEM Price will apply with effect from the time specified in a notice to be published on the IMO's website.

REASONS

Background

- 3 Clause 6.20.6 of the Market Rules requires the IMO to annually review the appropriateness of the value of the Energy Price Limits. Clause 6.20.7 states that in conducting the review, the IMO may propose revised values for the Maximum STEM Price and the Alternative Maximum STEM Price. If it does propose such revised values, the IMO must use the applicable methodology set out in clause 6.20.7(b) of the Market Rules.
- 4 Where, as a result of its review, the IMO has proposed a revised value for the Maximum STEM Price and/or the Alternative Maximum STEM Price, the IMO is required to prepare a draft report describing how it arrived at a proposed revised value of an Energy Price Limit. The IMO must publish the report on the Market Website¹ and advertise the report in newspapers widely published in Western Australia and request submissions from all sectors of the Western Australian energy industry, including end-users, within six weeks of the date of publication. After considering the submissions on the draft report, the IMO must propose a final revised value for any proposed change to an Energy Price Limit and submit those values and its final report, including submissions received on the draft report, to the Authority for approval.
- 5 The Market Rules require the Authority to review the final report provided by the IMO, including all submissions received by the IMO in the preparation of the report, and to make a decision as to whether or not to approve the revised value for any value comprising the Energy Price Limits.²

¹ Pursuant to the *Electricity Industry (Wholesale Electricity Market) Regulations 2004*, the IMO is required to maintain an internet website for the purpose of publishing and releasing information to Market Participants.

² Pursuant to clause 2.26.1(a) and (b) of the Market Rules.

- 6 In making its decision as to whether or not to approve any proposed change to an Energy Price Limit, the Authority must only consider³:
- whether the revised value for the Energy Price Limit proposed by the IMO reasonably reflects the application of the method and guiding principles for calculating the Energy Price Limits, described in clause 6.20 of the Market Rules; and
 - whether the IMO has carried out an adequate public consultation process.

The IMO's process

- 7 The IMO's annual Energy Price Limits review uses information on gas prices in Western Australia as an input variable. For the purposes of the IMO's 2011 Energy Price Limits review for the 2011/12 Reserve Capacity Year⁴ the IMO engaged ACIL Tasman to assist in undertaking a review of gas prices in the Wholesale Electricity Market.⁵ The outcomes of this review were used in the 2011 Energy Price Limits review.
- 8 The IMO engaged Sinclair Knight Merz (**SKM MMA**) to assist it in undertaking the 2011 Energy Price Limits review. SKM MMA provided the IMO with its draft report on the review of the 2011 Energy Price Limits on 3 June 2011, which was published on the IMO's website.⁶ The IMO invited submissions on SKM MMA's draft report by 20 July 2011. One submission was received from Synergy.⁷
- 9 The IMO invited Rule Participants to attend a workshop on the draft report, which was held on 7 July 2011. This workshop was attended by representatives from SKM MMA, Landfill Gas and Power, Synergy, ERM Power, the IMO and representatives from the Authority's Secretariat.⁸
- 10 The IMO provided the Authority with its final report, SKM MMA's final report and copy of a submission received during the public consultation process on 14 September 2011.

The Authority's process

- 11 The Authority has reviewed SKM MMA's draft report and final report, the submission from Synergy, and the IMO's final report on the review of the Energy Price Limits.

³ Pursuant to clause 2.26.1(c) of the Market Rules.

⁴ Reserve Capacity Years run from 8AM on 1 October to 8AM 1 October in the following year. The 2010/11 Reserve Capacity Year commences at 8AM on 1 October 2011 and finishes at 8AM on 1 October 2012.

⁵ See IMO website, Gas prices in Western Australia Review of 2011-12 inputs to the Wholesale Energy Market, http://www.imowa.com.au/f3841,1196293/2011_Review_of_Gas_Prices_Final_Report.pdf

⁶ See IMO website, Energy Price Limits for the Wholesale Electricity Market in Western Australia from October 2011, http://www.imowa.com.au/f4153,1360505/SKM_MMA_Draft_2011_EPL_Report.pdf

⁷ See IMO website, 2011 Energy Price Limits Review web page, http://www.imowa.com.au/2011_epl_review

⁸ See IMO website, 2011 Energy Price Limits Review Workshop Minutes, http://www.imowa.com.au/f4153,1540792/Minutes_-2011_Energy_Price_Limits_Review_v2_1.pdf

- 12 The Authority is of the view that the use of the Heat Rate at minimum capacity as required under the Market Rules is conservative and results in higher prices than using the heat rates based on observed dispatch levels. The Authority is also concerned that the additional cost of partial loading for the Pinjar units recovered through Ancillary Service payments have not been deducted in SKM MMA's analysis and hence have resulted in higher price limits.
- 13 The Authority considers that applying a short dispatch cycle of only up to six hours as the basis for Variable O&M costs in SKM MMA's modelling of the Energy Price Limits may have resulted in an intrinsic margin being included and has resulted in higher price limits.
- 14 The Authority is of the view that there is a low probability that the Pinjar unit, being one of Verve Energy's facilities, will utilise the spot market to obtain gas at a mean price of \$10.85/GJ. Hence, there may be an intrinsic margin already being included in the calculation of Fuel Cost by SKM MMA in modelling the Energy Price Limits.
- 15 The Authority is concerned with the biases referred to in paragraphs 12, 13 and 14 resulting from the methodology used by SKM MMA in deriving key input parameters and the appropriateness of the applied Risk Margin in light of these biases. In response to concerns raised by the Authority's Secretariat, the IMO agreed to apply downward pressure to the Maximum STEM Price modelled by SKM MMA and reduce the Risk Margin from 24.4% to 20%. This has resulted in a reduction of the Maximum STEM Price from \$326/MWh to \$314/MWh.
- 16 The Authority is satisfied with the IMO's approach in addressing the concerns raised and considers that the proposed revised values for the Energy Price Limits reasonably reflect the application of the methodology as defined in clause 6.20.7(b) of the Market Rules.
- 17 The Authority is satisfied that the IMO has carried out an adequate public consultation process. The IMO published the draft report prepared by SKM MMA describing how it arrived at the proposed revised values of the Maximum STEM Price and the Alternative Maximum STEM Price on the Market Website, accompanied with an invitation for submissions. The IMO also advertised a notice in newspapers widely distributed in Western Australia inviting submissions from all sectors of the Western Australian energy industry, including end-users.
- 18 The Authority is satisfied that the IMO has considered issues raised by Synergy, which is addressed in Section 3 of the IMO's final report. The Authority considers that the IMO has appropriately regarded and responded to submissions from interested parties for the 2011 Energy Price Limits review.
- 19 The Authority is of the view that there is an inconsistency between clause 6.20.7(a) and 6.20.7(b) of the Market Rules with respect to applying the short run marginal cost and short run average cost, respectively, in calculating the Maximum STEM Price. Clause 6.20.7(a) of the Market Rules refers to the Maximum STEM Price being based on the IMO's estimate of the short run average cost of the highest cost generating works in the SWIS fuelled by natural gas and is to be calculated using the formula in paragraph (b) of clause 6.20.7 of the Market Rules. Clause 6.20.7(b) of the Market Rules refers to the Risk Margin used to calculate the Maximum STEM Price being a measure of uncertainty in the assessment of the mean short run average cost for a 40 MW open cycle gas turbine generating station.
- 20 The Authority recommends that the IMO undertake a review of the relevant clauses in the Market Rules for the Energy Price Limits.

- 21 The Authority is in support of amending the Market Rules to extend the IMO's powers to request actual operational data from Market Participants to provide more accurate input to the modelling process as part of the Energy Price Limits review.
- 22 The Authority is also in support of the IMO's consideration in streamlining the annual review process for the determination of the Energy Price Limits as suggested by Synergy in its submission.

Conclusion

- 23 On the basis of this information, the Authority is satisfied that:
- the proposed values for the Energy Price Limits set out in the IMO final report reasonably reflect the application of the method and guiding principles for calculating the Energy Price Limits; and
 - the IMO has carried out an adequate public consultation process.