

Determination of the Ancillary Service Margin_Peak and Margin_Off-Peak Parameters

22 June 2012

Economic Regulation Authority



WESTERN AUSTRALIA

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DETERMINATION

1. Pursuant to clause 3.13.3A of the current *Wholesale Electricity Market Rules* (**Market Rules**), the Economic Regulation Authority (**Authority**) has determined the values for the Margin_Peak and Margin_Off-Peak parameters to be 25 per cent and 32 per cent, respectively.
2. Pursuant to clause 3.13.3A of the amended Market Rules, the Authority has determined the values for the Margin_Peak and Margin_Off-Peak parameters to be 32 per cent and 31 per cent, respectively.
3. The values under the amended Market Rules will be effective from the Balancing Market Commencement Day, expected to be 1 July 2012, to 30 June 2013. In the event that the Balancing Market Commencement Day begins after 1 July 2012, the values under the current Market Rules will be effective from 1 July 2012 until the Balancing Market Commencement Day.

REASONS

Background

4. Under clause 3.13.3A of the current 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.
5. The Independent Market Operator (**IMO**) has recently approved its Rule Change Proposal: Competitive Balancing and Load Following Market. The approved amendments to the current Market Rules are to take effect from the Balancing Market Commencement Day, expected to be 1 July 2012. These amendments include significant changes to the provision of Load Following Ancillary Service (**LFAS**), whereby a competitive market process will be introduced, allowing other Market Participants to provide this service. Hence, the Ancillary Service Margin_Peak and Margin_Off-Peak parameters will no longer include compensation for the provision of LFAS.
6. Clause 3.13.3AB of the amended Market Rules require the Authority to make a determination by the Balancing Market Commencement Day, i.e. the day the new Competitive Balancing and Load Following Market commences (no specific date is stated in the amended Market Rules).
7. In making the determination, the Authority is required to undertake a public consultation process and to take into account:
 - the Wholesale Market Objectives;¹ and

¹ The Wholesale 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

- the proposal submitted by the IMO.
8. 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.² These include:
 - the margin Verve Energy could reasonably have been expected to earn on energy sales foregone due to the supply of the required Ancillary Services; 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.
 9. On 30 November 2011, the IMO submitted to the Authority its proposed values for the Margin_Peak and Margin_Off-Peak parameters for the 2012/13 financial year under the current Market Rules, accompanied by a report prepared by its consultant Sinclair Knight Merz / McLennan Magasanik and Associates (**SKM MMA**). SKM MMA was engaged by the IMO to carry out an independent assessment and modelling of the margin values.
 10. On 28 March 2012, the IMO submitted its proposed values for the Margin_Peak and Margin_Off-Peak parameters for the new Competitive Balancing and Load Following Market, under the amended Market Rules, together with a report prepared by SKM MMA, for the period from the Balancing Market Commencement Day (expected on 1 July 2012) to 30 June 2013.
 11. The IMO's submissions are available on the Authority's website.³

Public Consultation Process

12. In accordance with the requirements of the current and amended Market Rules, the Authority issued a notice on 20 April 2012, inviting public submissions on the IMO's proposals. The Authority also published an issues paper to assist interested parties in making submissions. The period for public submissions closed on 18 May 2012.
13. One submission was received from Verve Energy. The submission is available on the Authority's website.
14. The main comments raised in Verve Energy's public submission include:

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.

² The Margin_Peak and Margin_Off-Peak parameters are used in the Ancillary Service settlement calculations under clause 9.9.2 of the current and amended Market Rules.

³ See ERA web site, Independent Market Operator – Submission under clause 3.13.3A(a) (inclusive of an independent assessment by the consultant SKM MMA) and Independent Market Operator – Margin values proposal for 2012/13 financial year (inclusive of an independent assessment by the consultant SKM MMA http://www.erawa.com.au/2/272/42/determination_of_the_imo_and_system_management_all.pm)

- Verve Energy considers the process and methodology applied by the IMO and SKM MMA to be appropriate.
- Verve Energy is supportive of the validation of the market modelling approach and verification of the input assumptions through the back-casting exercise undertaken prior to the modelling for the 2012/13 financial year;
- Verve Energy worked with the IMO and SKM MMA in the population of the assumptions and the development of the report provided to the Authority, and it is comfortable with the IMO's recommendations made to the Authority for the margin values.

Assessment

15. The Authority has assessed the IMO's proposals against the factors set out in clause 3.13.3A of the current and amended 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 the required Ancillary Services; and
 - issues raised in the public submissions.
16. The Authority has considered whether the proposed margin 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 for the market as a whole.
17. The Authority is of the view that there is no strong reason to retain Verve Energy as the sole provider for Spinning Reserve Ancillary Service at this stage of market development. The Authority understands that the structure used for introducing a competitive market for LFAS can be easily extended to the provision of Spinning Reserve Ancillary Service. The Authority considers it is appropriate for the IMO to lead the process for introducing a competitive market for the provision of Spinning Reserve Ancillary Service, with a target implementation date of 1 July 2013.
18. The Authority is generally satisfied that in proposing the values, the IMO has taken into account the margin Verve Energy could reasonably expect to earn on energy sales foregone due to supplying the required ancillary services; and the loss in efficiency of Verve Energy's Registered Facilities that System Management schedules to provide the required Ancillary Services.
19. The Authority has considered the proposed margin values proposed by the IMO and is of the view that they are reasonably reflective of the expected costs that would be incurred by Verve Energy in providing the required Ancillary Services.
20. In the Authority's determination paper for the margin values for the 2011/12 financial year published on 31 March 2011, the Authority recommended that the IMO conduct a review of the methodology and the process applied in deriving the values, prior to the next annual proposal. This stemmed from responses from

Market Participants in response to the Authority's issues paper on the proposed margin values for the 2011/12 financial year, which raised concerns that SKM MMA's methodology for forecasting the Availability Cost may over-compensate Verve Energy. The Authority is also concerned that the formula presented in SKM MMA's report for calculating the Availability Cost only takes into account the differential in Verve Energy's generation costs and generation volumes in providing the Ancillary Services, but not the differential in the system marginal price.

21. The Authority notes that the methodology used by SKM MMA in modelling the margin values for the 2012/13 financial year under the current and amended Market Rules is fundamentally the same methodology used in the previous reviews. SKM MMA has made adjustments to the assumptions based on the outcomes of an analysis of modelled versus actual Marginal Cost Administered Prices and generation volumes for the 2010/11 financial year, and comments provided by stakeholders. SKM MMA has only modified the methodology to account for the expected carbon price resulting from the implementation of the Clear Energy Future scheme on 1 July 2012.
22. The Authority is of the view that its recommendation to conduct a full review of the methodology and the process applied in deriving the values, has not been sufficiently fulfilled by the IMO by merely modifying the assumptions.
23. However, the Authority notes that determination of the margin values by the Authority may not be required in the future if the IMO develops a competitive market for Spinning Reserve Ancillary Service.

CONCLUSION

24. Based on the assessment discussed above, the Authority determines that the values of the Margin_Peak and Margin_Off-Peak parameters from the Balancing Market Commencement Day to 30 June 2013 to be 32 per cent and 31 per cent, respectively, under the amended Market Rules.
25. In the event that the Balancing Market Commencement Day begins after 1 July 2012, the Authority determines that the values of the Margin_Peak and Margin_Off-Peak parameters from 1 July 2012 to the Balancing Market Commencement Day to be 25 per cent and 32 per cent, respectively, under the current Market Rules.