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Determination of the Ancillary Service Cost LR, Margin_Peak and Margin_Off-Peak parameters – Issues Paper
Economic Regulation Authority
PO Box 8469
Perth Business Centre, WA 6849

Email: publicsubmissions@erawa.com.au

RE: Submission to the Determination of the Ancillary Service Cost LR, Margin_Peak and Margin_Off-Peak parameters – Issues Paper

Griffin appreciates the opportunity to make a late submission on the above Issues Paper.

The setting of the Margin_Peak and Margin _Off-Peak parameters has a large impact on a small number of generators – specifically those generators with facilities of installed capacities greater than 200MW. These facilities, when operating above 200MW, are liable for much of the Ancillary Service (spinning reserve) cost in the market.

With regard to the process of determining the annual Margin_Peak and Margin _Off-Peak parameters, Griffin is disappointed that there has not been broader consultation with stakeholders prior to the ERA's Issues Paper. We understand that there will naturally be some commercial sensitivity around Verve Energy's operations, as indicated by the IMO in their submission to the ERA, but there are a number of assumptions around the process itself that may have benefited from broader participation.

The IMO's consultants, SKM-MMA, has used a dynamic equilibrium modelling technique, utilising the PLEXOS software. While this type of modelling is normally appropriate in modelling efficient market behaviour, such as the setting of marginal prices by the marginally dispatched participant, it assumes a gross pool dispatch model. Such a model assumes that real-time pricing decisions allow efficient cost pass-through. The WEM is not a real time gross dispatch market, and hence not necessarily efficiently priced (the weakness in the day-ahead STEM to predict accurate overnight balancing prices is an example). The requirement for heavily bilaterally contracted generators to meet resource plans in a day-ahead market may lead to conservative bidding behaviour. Some of the assumptions that would be made by the modelling software would not occur in reality.

The methodology for forecasting the *Availability Cost*, or the amount required to compensate Verve for supplying the service is summarised by the equation:

Availability Cost = (GenCost_Res – GenCost_NRP) + (GenQ_NRP – GenQ_Res) x SMP

It appears as if the first term of this equation is describing the difference in the costs incurred by Verve with and without supplying the service. If Verve were to be compensated on the basis of recouping its costs only, then this would equal the Availability Cost. However, Verve is also allowed an *Opportunity Cost* component to compensate it for foregone margin by not being able to utilise the plant used for the provision of Ancillary Services to supply customer loads. This is given by the second term in the equation, where the difference in volume of output is multiplied by the System Marginal Price (effectively our MCAP). Griffin is confused a little by this. It appears as if the second term is effectively the SRMC of the marginal unit in the STEM price stack. This is not a margin. All things being equal, the next available generator in the price stack would happily supply a marginal unit of energy at this price – meaning they are compensated fully by the second term in the equation only. It appears as if Verve may be being overcompensated by this method of setting the Availability Cost (i.e. the second term should only refer to an appropriate margin).

Additional to the logic behind the methodology, the second term of the equation is effectively the SRMC derived from the MCAP price curve. SRMC calculations normally assume that the fixed fuel transport cost component of the gas transport tariff is a sunk cost and not introduced to the SRMC calculation. It appears as if SKM-MMA has included the fixed gas pipeline transport costs in its modelling.

Griffin appreciates being able to lodge a submission for the consideration of the Authority post the specified closing date. Please contact me if you have any queries relating to this submission.

Yours sincerely,

Shane Cremin
GM – Policy & Strategy