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Dear Chris

DETERMINATION OF THE ANCILLARY COST LOAD REJECTION, MARGIN PEAK AND MARGIN OFF-PEAK PARAMETERS – ISSUES PAPER

Alinta Sales Pty Ltd (Alinta) appreciates the opportunity to comment on the Economic Regulation Authority's (Authority) Issues Paper on the Determination of the Ancillary Service Cost Load Rejection (LR), Margin Peak and Margin Off-Peak parameters.

Alinta has commented only on certain issues arising from the Authority's Issues Paper and the IMO's (and its consultant, SKM MMA) 2010 review of the values for the Margin Peak and Margin Offpeak parameters (2010 Review). The absence of a comment on any specific issue should not be taken to indicate that Alinta supports, or does not support, that particular aspect of the 2010 Review.

Change in Market Rules

Alinta notes that prior to the Market Rules being amended by RC_2010_01, the Authority was required to undertake an assessment to determine values for the Margin Peak and Margin Offpeak parameters every three years.

In its 2009 review of the values for the Margin Peak and Margin Offpeak parameters (2009 Review), which covered the period 2010/11, 2011/12 and 2012/13, the IMO, based on advice from MMA, proposed that the average Margin Peak and Margin Offpeak values for the three years be adopted, reflecting the average annual cost incurred by Verve Energy over the three period. This resulted in values of 30 per cent and 103 per cent being adopted for the Margin Peak and Margin Offpeak parameters respectively, which were approved by the Authority.

However, in its report, MMA also estimated that based on its assumptions, the estimated costs incurred by Verve Energy in 2010/11 in providing ancillary services would be lower than the three year average, and that if only that year was considered, the Margin Peak and Margin Offpeak parameter values would have been 20 per cent and 86 per cent respective.

Given the amended Market Rules now require an annual adjustment of the Margin Peak and Margin Offpeak parameter values, it appears that Verve Energy will have been over-compensated for ancillary services provided during 2010/11 compared with what it would have been able to recover had the rules been amended earlier. Disappointingly, because the Margin Peak and Margin Offpeak parameter values are now adjusted annually, Market Participants will not be able to benefit of this overpayment in 2010/11 in later years.

Review process

In contrast to the 2009 Review, during which all Market Participants had an opportunity to provide input on the modelling assumptions, Alinta notes that for the 2010 Review, the key modelling assumptions were only reviewed by the IMO, System Management and the Authority, while Verve Energy was asked to confirm assumptions made with regards to its facilities.

In its covering letter, the IMO comments that it *"…considered that given the limitations of confidentiality requirements a wider consultation process would be of limited benefit."* Had the IMO chosen to consult Alinta on the assumptions made in the 2010 Review with regards to its facilities, the following comments would have been made.

- The assumptions that are detailed by MMA with respect to Alinta's facilities in the 2009 Review (Table 4.3) are more accurate than those detailed by SKM MMA in the 2010 Review (Table 4.4).
- Whether sufficient gas is available is only one factor influencing whether Alinta's Wagerup facility operates on gas or distillate. Also relevant are the spot market gas prices and STEM prices.

While broader consultation with Market Participants would have been preferred prior to the IMO submitting its proposal to the Authority, given the significant change in the fuel price assumptions in the 2010 Review (commented on further below), Alinta considers the Authority should request the IMO to explain the basis on which it concluded that the fuel price assumptions in ROAM's report represent a more appropriate set of assumptions than those previously derived by MMA in consultation with Market Participants or by ACIL Tasman, which was engaged by the IMO to advice it on a gas price range to apply for the 2010 Energy Price Limits review.

Approach to modelling of ancillary services costs

As for the 2009 Review, the IMO engaged SKM MMA (previously MMA) to undertake the 2010 Review. In its report, SKM MMA notes that it undertook:

> *"…market modelling using PLEXOS simulation software, which co-optimised energy and reserve provision to determine least-cost dispatch, treating the WEM as a gross pool market. Although bilateral trades, the STEM and Balancing Mechanism were not modelled explicitly, the dispatch outcomes from simulation of the gross pool assuming short run marginal cost (SRMC) bidding should be equivalent to economically efficient WEM outcomes.*

To assess the reserve availability cost that could reasonably be expected to be incurred by Verve Energy for the financial year starting 1 July 2011, revenue and generation cost outcomes were compared from two market simulations with and without SR and Load Following Reserve (LFR) provision. (p.1)

The modelling approach applied by SKM MMA cannot be replicated without access to its version of the PLEXOS simulation software and full details of the assumptions around input parameters. It is therefore difficult for other parties to comment on the reasonableness of the modelling results generated by SKM MMA.

However, given that this approach has been employed for a number of years, Alinta suggests it may be prudent to examine its robustness to the extent this can be achieved. For example, the availability cost is dependent on a number of values that are estimated through the PLEXOS simulation software, including:

- Verve Energy's total generation costs, including start-up costs, with reserve provision (*GenCost_Res*);
- Verve Energy's total generation volume, with reserve provision (*GenQ_Res*); and
- the system marginal price with reserve provision.

To the extent that these parameters have been estimated for previous years (or historic data could be used to replicate results for certain years), it should be possible to compare Verve Energy's actual generation costs and volumes with the estimates generated by the PLEXOS simulation software. While the results of such comparisons would need to be viewed and interpreted with caution, including because the simulations assume economically efficient outcomes, they would nevertheless provide an important indicator of whether the costs estimated to be incurred by Verve are reasonable.

Gas prices

The table below summarises the fuel price assumptions used by SKM MMA for the 2010 Review and by MMA for the 2009 Review. Alinta escalated MMA's estimates into real June 2010 estimates using the Australian Bureau of Statistics' eight capital cities CPI.

Table 1 Fuel price assumptions

Fuel type	Price ($/GJ) 2010/12 (real June 2009 dollars)	Price ($/GJ) 2010/12 (real June 2010 dollars)	Price ($/GJ) 2011/12 (real June 2010 dollars)	Change
Coal	2.00	2.06	2.00	-3.0%
Cogeneration gas	2.41	2.48	2.00	-19.5%
Verve contract gas	4.39	4.52	3.00	-33.7%
IPP contract gas	4.39	4.52	4.00	-11.6%
New gas	7.45	7.68	6.00	-21.8%
Landfill gas	na		2.18	na
Distillate	21.93	22.60	18.35	-18.8%

SKM MMA and the IMO indicate that assumption relating to natural gas prices have been brought into alignment with assumptions used in the ROAM Consulting report *Assessment of FCS and Technical Rules*, which was prepared for the IMO and the Renewable Energy Generation Working Group. This report states that, based upon gas price projections and contract positions, the following gas prices were assumed: Verve - $3/GJ, rising to $9/GJ from 2015; existing independent power producers (IPPs) - $4/GJ; and new entrant IPPs - $6/GJ, rising to $9/GJ from 2015.

Alinta notes that the objective of the ROAM report was to analyse the frequency control service requirements in the South West Interconnected System (SWIS) for different penetration levels of intermittent renewable energy generation. While ROAM provided estimates of comparative costs for frequency control services at different levels of wind generation, it noted that *"…[t]hese costs are based upon the assumption that existing Rules and market conditions continue; costs could be much higher under alternative assumptions (for example, with higher gas prices, or a carbon price,…"* (p.iii).

Alinta notes that the ROAM report does not detail the information on which it based its natural gas price assumptions. In any event, it would appear that the accuracy of ROAM's fuel price assumptions may have been less critical in that study, as the objective appeared predominantly focussed on Verve Energy's technical ability to meet frequency control service requirements under different penetration levels of intermittent renewable energy generation.

In the 2010 Review, SKM MMA indicates that it based its assumed gas transport charges on those estimated by ACIL Tasman, which as noted earlier was engaged by the IMO to advice it on a gas price range to apply for the 2010 Energy Price Limits review. However, neither SKM MMA nor the IMO indicate why the actual gas price range estimated by ACIL Tasman in that report was discarded in favour of the assumptions used by ROAM. In this context, in its May 2010 Final Report, ACIL Tasman stated the following.

- Major portfolio gas commodity costs could range from $3.50 through to $10.50 per GJ, centred around a normally distributed mean of $7 per GJ.
- Spot prices tend to have a premium to large portfolio gas costs – although this depends on the degree to which the market is long or short on any particular day. An 80 per cent confidence interval for spot market commodity cost ranges from $5 to $12 per GJ, with a skew-normal distribution mode of $8 per GJ.

Should you require any further information regarding Alinta's submission, or wish to discuss further any of the issues raised by Alinta, I can be contacted upon 08 9486 3749.

Yours Sincerely

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