

Our ref: RSC 014  
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## **NOTICE OF PUBLIC CONSULTATION – 2010 MAXIMUM RESERVE CAPACITY PRICE FOR THE 2012/13 RESERVE CAPACITY YEAR**

The Independent Market Operator (IMO) as part of its obligations under the Market Rules determines the Maximum Reserve Capacity Price (MRCP). This sets the maximum bid that can be made in a Reserve Capacity Auction and is used as the basis to determine an administered Reserve Capacity Price if no auction is required.

This year the IMO requested The Allen Consulting Group to review the Major components of the Weighted Average Cost of Capital used in calculation of the Maximum Reserve Capacity Price to apply for the 2010 Reserve Capacity Cycle. A number of changes to the Major components were suggested. A copy of The Allen Consulting Group report is available on the IMO webpage<sup>1</sup>. Since the release of the IMO's draft MRCP report on 20 November 2009 the IMO has reviewed the requirements of the Market Procedure and decided to reissue the draft report using the Major components as prescribed in the Market Procedure.

By using the prescribed values for the Major components there has been an increase in the calculated WACC from 6.89% to 7.78%. This results in an increase in the value of the MRCP that was published previously by the IMO from **\$216,800 to \$231,300**.

A full breakdown of the parameter values and calculation of the WACC are provided in Appendix 1 of this notice.

As a result of this change, the IMO will extend the period of public consultation to allow for comments on the new proposed price. The end of the public consultation period is therefore extended from 18 December 2009 to 4 January 2010. Submissions will formally close on:

**4:00pm WST on Wednesday 4 January 2010.**

All enquiries should be directed to Troy Forward or Ben Williams by email via [imo@imowa.com.au](mailto:imo@imowa.com.au) or telephone (08) 9254 4300.

**TROY FORWARD  
MANAGER, MARKET DEVELOPMENT AND SYSTEM CAPACITY**

10 December 2009

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<sup>1</sup> <http://www.imowa.com.au/mrcp>

## APPENDIX 1 - WEIGHTED AVERAGE COST OF CAPITAL

The pre tax real Officer WACC is used for the determination of the Maximum Reserve Capacity price. The formulae is shown below:

$$WACC_{real} = \left( \frac{(1 + WACC_{no\ min\ al})}{(1 + i)} \right) - 1$$

and

$$WACC_{no\ min\ al} = \frac{1}{(1 - t(1 - \gamma))} R_e \frac{E}{V} + R_d \frac{D}{V}$$

Where;

The nominal Return on Equity is calculated as:

$$R_e = R_f + \beta_e \times MRP$$

And

The nominal Return on Debt is calculated as:

$$R_d = R_f + DRP$$

The Allen Consulting Group reviewed the minor parameters and updated the relevant parameters in line with current prices and values. A table of the parameters and values are shown below:

**Table A1: PRICECAP[2009] and associated parameters**

Parameter	2010 Value	2009 Value
Nominal Risk Free Rate of Return (%)	5.62	4.98
Expected Inflation (%)	3	3
Real risk free rate of return (%)	3.15	3.12
Market Risk Premium (%)	6	6
Asset beta	0.5	0.5
Equity beta	0.83	0.83
Debt Margin (%) , DRP (%)	3.22	3.2
Debt issuance costs (%)	0.125	0.125
Corporate tax rate (%)	30	30
Franking credit value	0.5	0.5
Debt to total assets ratio (%)	40	40
Equity to total assets ratio (%)	60	60

For the purposes of the 2009 MRCP:

**WACC = 7.78%**