



St Georges Square
Level 8, 225 St Georges Terrace
PERTH WA 6000

PO Box 5796
PERTH WA 6831

T: +61 8 9261 2888
F: +61 8 9261 2880

Julian Fairhall
Principal Analyst
Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
Perth WA 6000

20 February 2017

Dear Mr Fairhall

RESPONSE TO ISSUES PAPER – MARGIN VALUES FOR THE 2017/18 FINANCIAL YEAR

Bluewaters welcomes the opportunity to provide comments on the paper entitled “Issues Paper – Margin Values for the 2017/18 Financial Year” ([Issues Paper](#)). This paper was published by the Economic Regulation Authority (Authority) on 28 December 2016.

Bluewaters notes that the Authority is, through this Issues Paper, conducting a consultation under MR 3.13.3A(b). Bluewaters also notes this consultation is based on a [proposal of Spinning Reserve \(SR\) Margin Values submitted by AEMO](#) under MR 3.13.3A(a). Bluewaters further notes that AEMO has engaged Jacobs Group Pty Ltd (Jacobs) to provide an independent assessment of the Margin Values for the 2017/18 financial year.

Bluewaters notes that MR 3.13.3A requires the Authority to determine the Margin Values taking into account the Wholesale Market Objectives.

SR Margin Values have increased substantially compared to FY 2016/17

Bluewaters notes that, compared to FY 2016/17, the FY 2017/18 theoretical Availability Cost (if approved) will increase by \$2.74M. This has in turn resulted in substantial increases in the proposed SR Margin Values.

Bluewaters considers the proposed significant increases in the SR Margin Values require further substantiation considering that the determination is a theoretical process with no apparent reconciliation on previous year’s forecasts versus actuals. The SR Margin Values whilst levied on generators will ultimately need to be passed onto customers. It is therefore critical that such increases in SR Margin Values be carefully examined by the Authority in order to ensure that no higher-than-necessary Availability Cost will be imposed on customers.

AEMO’s consultation process

Bluewaters notes that some of the details in the Jacobs’ assessment are commercially sensitive. Hence it is understood that the assessment report has not been able to provide sufficient information for Market Participants to satisfy themselves that Jacobs’ modelling outcome represents an efficient dispatch outcome in the WEM. Bluewaters notes that it had a discussion with Jacobs and AEMO in relation to this report on 15 February 2017 but this still left some questions unanswered.

In the absence of such verifiable information, Bluewaters considers relying on the “black box” modelling outcome to be a leap of faith. For Bluewaters to have confidence in the modelling outcome, Bluewaters recommends that the Authority examines the modellings from Jacobs¹ for the past SR Margin Values determinations and verify that they closely approximate the actual:

- dispatch for the relevant determination periods;
- Balancing Prices; and
- AEMO payments of Availability Cost.

¹ Or the previous consultant who performed the modelling.

From this analysis, Bluewaters recommends that the Authority substantiates the proposed SR Margin Values by demonstrating that the past modellings were sufficiently robust.

Bluewaters considers the regulatory risks in regards to SR Margin Values determination can be mitigated by ensuring transparency in the consultation process. As discussed earlier, Bluewaters appreciates that AEMO may not be able to release all details in Jacobs' modelling because it contains information that is commercially sensitive. However, Bluewaters considers transparency can be improved by AEMO:

- performing and providing summaries of sensitivity analysis on the modelling outcomes;
- allowing stakeholders better access to the party who performs the modelling to make the necessary inquiries, including holding Q&A sessions;
- conducting stakeholders consultation on the modelling results and the proposed SR Margin Values before finalising them for submission to the Authority. AEMO may wish to hold the consultation in multiple iterations.

Bluewaters considers, by allowing better transparency of the modelling and SR Margin Values proposal process, regulatory risk can be mitigated by: (a) allowing stakeholders to better understand the drivers of changes that affect the market; and (b) allowing stakeholders to take the necessary actions to assist in mitigating the impact of the regulatory risks.

Jacobs' modelling for FY 2017/18

Bluewaters consider it a role of the Authority to satisfy itself that the Jacobs modelling outcome does represent an efficient dispatch for the WEM. To achieve this, Bluewaters recommends that the Authority:

- verifies that the modelling outcome of shutting down (or backing off) the Cockburn CCGT represents the most efficient dispatch option for providing the SR. In the [2016/17 modelling report](#), Jacobs recommended that Kemerton to be backed off for providing SR². This differs from the recommendation for 2017/18 where Jacobs recommended that Cockburn CCGT be backed-off (or shut down) and use Kemerton (among other units) to provide SR³. Bluewaters recommends that the Authority explains in its determination report as to why this aspect of the recommendations has changed and how would it provide the most efficient dispatch outcome to the WEM.
- examines the role of start costs in the modelled Balancing Prices. Jacobs advised in its report that one of the key drivers behind the increase in Synergy's Availability Cost is that "start costs have increased in this year's simulations due to more frequent stops and starts". Bluewaters recommends that the Authority seeks clarifications as to whether the increased start costs have been appropriately factored into the modelled Balancing Prices.
- examines the gas pricing assumption. Bluewaters notes that Jacobs has used gas prices associated with long term gas supply contracts (\$6.7/GJ) and did not use gas spot prices trading in the order of \$4.5/GJ. This suggests a large variation between gas cost and gas value. Bluewaters considers the decision on gas pricing to be critical in particular as Bluewaters understands that the proposed SR Margin Values are highly sensitive to this assumption. It is also interesting to note that the gas price increase does not appear to have been reflected in the forecast Balancing Price increase. This suggests that the Balancing Prices are reflective of fuel value whilst Availability Cost is being determined on fuel cost. Bluewaters recommends that the Authority review the validity of using cost as opposed to value in the determination of the gas price input.

Bluewaters notes that, as the SR Margin Value increases are for the most part passed through to customers, there does not appear to be a level of scrutiny in this consultation compared to other regulatory determinations. As such the Authority holds a very important role in ensuring that it has examined all aspects of the Jacobs' assumptions and assessment.

Can Bluewaters help?

For this 2017/18 SR Margin Values cycle, in order to assist the WEM in reducing the SR Margin Values (thereby reducing the cost burden in the WEM), Bluewaters has proposed that the AEMO or the Authority considers the option of Bluewaters providing additional SR capacity to the WEM (in addition to what it has

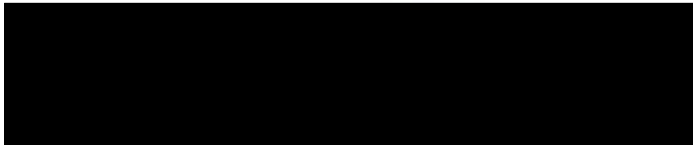
² During the peak period.

³ It appears that this applies for both peak and off-peak periods.

already provided). Bluewaters recommends that the Authority explores this option with Bluewaters to examine if this will reduce the SR Margin Values and in turn promotes the Wholesale Market Objectives.

Should you have any questions regarding this submission please contact Ignatius Chin on 08 9261 2890 or Ignatius.Chin@Bluewatersps.com.au.

Yours sincerely



Andrew Sutherland
Chief Operating Officer