



Minutes

Meeting Title: BRCP Working Group meeting 2 - Discussion of preliminary procedure change proposal

Meeting Number: 2/2020

Date & Time: Tuesday, 6 October 2020 10:00am (AWST)

Location: Online Meeting

Attendees:

Sara O'Connor	Economic Regulation Authority (Chair)
Matt Shahnazari	Economic Regulation Authority (Presenter)
Andrei Costache	Australian Energy Market Operator
Andrew Rayner	Energy Policy WA
Chi Ong	Economic Regulation Authority
Daniel Kurz	Bluewaters Power
Dimitri Lorenzo	Bluewaters Power
Dora Guzeleva	Energy Policy WA
Emma Forrest	Economic Regulation Authority
Grace Liu	Australian Energy Market Operator
Graham Pearson	Australian Energy Council
Jo-Anne Chan	Synergy
John Nguyen	Perth Energy
Oscar Carlberg	Alinta Energy
Patrick Peake	Perth Energy
Rebecca Herbener	Economic Regulation Authority
Steve Gould	Community Electricity
Lipakshi Dhar	Economic Regulation Authority
Umi Joshi	Economic Regulation Authority
Dale Waterson	Palisade

Apologies:

Devendra Singh	Collgar Wind Farm
Jason Dignard	Economic Regulation Authority
Jenny Laidlaw	Rule Change Panel
Julian Fairhall	Economic Regulation Authority
Kate Ryan	Energy Policy WA
Laura Koziol	Rule Change Panel
Madelin Pow	Energy Policy WA
Neetika Kapani	Australian Energy Market Operator
Jacinda Papps	Alinta Energy
Paul Arias	Bluewaters Power
Stephen Eliot	Rule Change Panel

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1. Welcome by Sara O'Connor

Sara O'Connor, Committee Chair, opened the meeting and welcomed everyone to the second meeting of the Working Group at 10:00 am.

2. Meeting Apologies / attendance

The Chair noted the attendance list as above.

3. Project Schedule

The Chair advised all members that the procedure change proposal was currently out for consultation, which was closing on Wednesday, 14th of October. The Economic Regulation Authority will consider any submissions received when preparing the procedure change report. The procedure change report would then be submitted to the ERA Governing Body for approval on the 4th of November and then depending on the feedback received, it would be published on ERA website by the 10th of November. This would allow Australian Energy Market Operator (AEMO) sufficient time to use it to calculate the Benchmark Reserve Capacity Price (BRCP) that was going to apply for 2021 Reserve Capacity Cycle.

4. Summary of the procedure change proposal

Mr. Shahnazari gave a presentation on the preliminary procedure change proposal. A copy of the presentation is available on the Rule Change Panel's [website](#).

The following points were discussed:

- The first meeting of the working group was held on 18 August 2020 and the minutes of that meeting was published on the ERA webpage.
- Stakeholders raised concerns that the BRCP for the 2021 reserve capacity cycle may not be available based on the new market procedures and the main concern was the outdated weighted average cost of capital (WACC) parameters used for the calculation of the BRCP, which would be applied to the 2021 reserve capacity cycle.
- The ERA hence considered the option to expedite the review by limiting the scope of the review to the calculation of the WACC parameters only. The ERA received support from the working group in the first meeting which considered to fast track the process.
- The ERA engaged with AEMO to consider how the BRCP for the 2021 Reserve Capacity Cycle can be updated based on the new WACC parameters, considering that AEMO had already started the process for the calculation of the BRCP this year based on the current market procedure.
- According to the project timeline, the ERA Governing Body met to approve the procedure change proposal on the 9th of September and on the 15th of September, published the procedure change proposal for 20 business days public consultation. The ERA is expected to publish the procedure change report on 4th of November ensuring that the new market procedure, which would be based on the updated WACC parameters, would be available to AEMO for application to the 2021 Reserve Capacity Cycle BRCP.

5. Discussion on the procedure change proposal

The following points were discussed:

- Mr. Shahnazari informed members that the biggest change that had been proposed was moving from applying a real WACC to using a nominal WACC. The issue was that, in the current market procedure, it was ambiguous whether a real WACC or a nominal WACC should be used in the calculation. In practice, AEMO used a real WACC in the calculation.

- The ERA is proposing to do the calculation based on a nominal WACC as it ensures financing costs also include compensation for forecast inflation and this also brings some computational advantages. For example, there is no longer a requirement to forecast inflation rate, which was another contentious area.
- There have been other updates to the WACC parameters and slight adjustments have been made to the market risk premium, debt insurance costs and franking credit value. All of these changes were based on ERA's decisions in other calculations for rail and pipeline, and electricity network regulation.

6. Future reviews of the market procedure: matters to be included in the review of the market procedure next time.

Mr. Shahnazari encouraged members to provide feedback on the proposed changes, as well as any other matters that was of importance for the review of the BRCP in the next review of the market procedure, which the ERA hoped to do after the completion of reforms. Moreover, Mr. Shahnazari advised that there were interactions with capacity credit pricing, and other elements of the reserve capacity mechanism that needed to be considered prior to conducting a comprehensive review of the BRCP, including the choice of reference technology and identification and estimation of costs. For example, fixed operating and maintenance costs.

Mr. Peake mentioned that he was pleased with everything that had been put forward in the meeting and that it all looked rational to him. Additionally, Mr. Peake queried the difference between nominal and real WACC. In reply, Mr. Shahnazari explained that the difference between real and nominal WACC was the forecast inflation rates. Nominal WACC included a compensation for the effect of inflation to investors, and that was done in practice, and it made sense logically and rationally to compensate investors for the effect of inflation. Furthermore, by applying a nominal WACC, it was ensured that investors were going to be compensated for the effect of inflation.

Mr. Carlberg seconded Mr. Peake's comments and further added that he supported the changes and appreciated the explanation and changes to the nominal WACC which would result in a much more sensible looking WACC.

Mr. Kurz also agreed with ERA's approach.

Mr. Carlberg raised a query in regards to the equity beta issue. Mr. Carlberg noted that there seemed to be quite a limited amount of information to determine what's appropriate. Additionally, he questioned that aside from looking at what equity betas were published, was there any other approach that could be taken to examine that or were they always limited to what equity betas were out there in similar companies? To this, the Chair mentioned that they would always use that as a starting point, just to see what other comparable information was out there. If comparable data is not available then regulatory discretion can be applied but this is subjective. The Chair further mentioned that based on the conversations that she had, it would be difficult to apply regulatory discretion to an equity beta whilst the market was still moving from current design to a new design. Additionally, the Chair advised that once the market reforms had gone through, a comparison could then be made between the level of risk there with the level of risk beforehand, and then some sort of determination could be made on whether or not risk is increased or reduced.

The Chair requested Mr. Shahnazari to provide an update on why the ERA did not proceed with the full review of BRCP, just so people could understand the reason as to why reference technology could not be looked at this time around. The following points were mentioned by Mr. Shahnazari:

- Mr. Shahnazari explained that the calculation of the BRCP and pricing of reserve capacity seeks to emulate the outcomes of an auction for the procurement of capacity credits. He explained that one needed to understand how many capacity credits each technology was going to receive, because the pricing or bids into such auction was based on a price per capacity credit. The BRCP emulates the price the marginal technology in the auction would be willing to receive. So, one needed to first estimate the amount of capacity credits that are expected to be assigned to technologies before identifying the benchmark technology. The assignment of capacity credits to facilities was currently under development by Energy Policy WA (EPWA).
- The other aspect of it is the pricing of capacity credit and capacity credit demand curve and the assumptions used in calibrating the curve. Last time the Public Utilities Office revised the capacity credit demand curve, it assumed the BRCP reflects the gross cost of new entry for the benchmark facility. A gross cost of new entry ignores the possible profits of facilities from participation in the energy and ancillary services markets. Any technology coming into the market, through the capacity credit procurement auction, factors in the cashflows from all markets, including capacity and energy and ancillary services.
- Mr. Shahnazari explained ideally the review of the BRCP and capacity credit pricing curve should be conducted concurrently to ensure consistency. The choice of benchmark technology is also dependent on whether or not energy and ancillary services cash flows are accounted for in the calculation of the BRCP.
- The ERA does not currently have any function to review the capacity credit demand curve. From September 2022, the ERA would have the function to consider the calibration of the capacity credit pricing curve. It then would be more sensible to do all the reviews together, both the calibration of the capacity credit demand curve, and the calculation of the BRCP.
- Mr. Shahnazari explained that these principles have already been implemented in other jurisdictions, for example, North America. The current design for WA markets is that the calibration of the current capacity pricing curve does not consider possible revenues from energy and ancillary services markets.

Mr. Peake commented that the idea was that if one gets paid the gas turbine price and they bid at marginal cost, then there would be an adequate return for generators going in. Taking the cost of essential system services and such like, one must be careful that it would not result in a price which would start to make existing generation uneconomic. The consequence of this would be that generators would be forced out of the market, even though the floor price would still be dispatched for a little while. Furthermore, there would be a risk of shortage if generators are forced out of the market when there aren't available replacements. The whole basis of the reserve capacity price was to ensure that there were no shortages.

The Chair advised that they go through a full stakeholder engagement and review process once they are certain to conduct a review in the future.

7. General business

The Chair advised members that they were welcome to make submissions and that the ERA would consider those when finalising the market procedure change. Unfortunately, due to time constraints, the ERA would not be able to allow any extension for late submissions.

Meeting closed at 10:25am