

Review of market procedure 2020: the benchmark reserve capacity price

Market Advisory Committee Working
Group

Meeting of 6 October 2020



Economic Regulation Authority

WESTERN AUSTRALIA

First working group meeting

- The MAC Working Group met on 18 August
 - Minutes available on the Group [webpage](#).
- Received feedback from stakeholders:
 - Concern: the BRCP for the 2021 reserve capacity cycle would be based on the existing market procedure.
- Option to expedite the review:
 - Focus on updating parameters for the weighted average cost of capital (WACC).

Fast-track process

- The Working Group agreed with the ERA to limit the scope of the market procedure to the review of WACC parameters only.
 - This would allow for a fast-track process.
- The ERA has engaged with AEMO to consider how the 2021 reserve capacity cycle BRCP can be updated based on new WACC parameters.
 - AEMO has started its process for the calculation of the BRCP this year.
- The ERA published the [procedure change proposal](#) on 15 September (inviting comments until 4:00pm 14 October)

Timeline

Date	Milestone	Progress
9 September	The ERA Governing Body meets to approve the procedure change proposal.	Completed
15 September	The ERA publishes the procedure change proposal for a 20-business day public consultation.	Completed
6 October	Working Group meeting #2 The ERA will also seek feedback on other matters than WACC parameters (for future reviews).	Today's meeting
4 November	The ERA publishes the procedure change report.	

Proposed changes

- Move from real WACC to nominal WACC
 - Ensures financing costs includes compensation for forecast inflation.
 - This also brings computational advantages: no longer required to forecast inflation rate (which was another contentious area)
- Other updates to WACC parameters:
 - Market risk premium, debt issuance cost, franking credit value

Illustrative effect of proposed changes

Table 3: Illustrative rate of return for BRCP

	Final Report for 2020 ¹⁰²	Proposed market procedure change
Nominal risk free rate (%)	0.98	0.98
Expected inflation (%)	2.36	n/a
Market risk premium (%)	6.0	5.9
Equity beta	0.83	0.83
Debt risk premium (%)	2.23	2.23
Debt issuance costs (%)	0.125	0.100
Corporate tax rate (%)	30	30
Franking credit value	0.25	0.50
Debt to total assets ratio (%)	40	40
Pre-tax nominal WACC (% per annum)	5.95	5.47
Pre-tax real WACC (% per annum)	3.51	n/a

Other matters related to the calculation of the BRCP

- Next review of the BRCP procedure
 - After completion of reforms
 - Interaction with capacity credit pricing and other elements of the reserve capacity mechanism
- The ERA seeks feedback from the Working Group
 - Choice of reference technology: overlap with the current reform process.
 - Identification and estimation of costs: for example, fixed operating and maintenance costs

Thank you

Ask any questions



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