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Economic Regulation Authority
Level 4, Albert Facey House
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Attn: Sara O'Connor

Emailed via: publicsubmissions@erawa.com.au

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Dear Ms. O'Connor

RESPONSE TO ISSUES PAPER – ANCILLARY SERVICE COSTS – SPINNING RESERVE, LOAD REJECTION RESERVE, AND SYSTEM RESTART (MARGIN VALUES COST_LR) for 2021/22

Bluewaters welcomes the opportunity to provide comments on “Ancillary service costs – Spinning reserve, load rejection reserve, and system restart (Margin Values Cost_LR) for 2021/22” (Issues Paper), released by the Economic Regulation Authority (Authority) on 9 February 2021, as well as “Addendum to the Margin Values and cost_LR 2021/22 issues paper” (Addendum), released on 12 March 2021.

Bluewaters offers the below observations for consideration by the Authority.

Question 1 & 2: Changing market dynamics and the relative costs of Spinning Reserve and Load Rejection Reserve

The design principles of the WEM are based on the specific set of circumstances and technologies that existed around 20 years ago, where fossil fuel generation (coal, gas and diesel) supplied the overwhelming majority of energy; and where SRMC v capex hierarchies were well established. With behind the meter solar reducing grid-facing demand in the middle of the day and low-cost grid-connected, but non-schedulable (i.e. variable), solar and wind generation displacing thermal generation, wholesale prices have become more volatile. This is most prominent with the increasing incidence of negative price intervals.

As stated in the Issues Paper and further in the Addendum, the challenges of transitioning from the traditional supply structure to a more distributed and renewable energy future will put pressure on existing ancillary service products – at least until technology is adopted in sufficient quantities to smooth the variability in demand and supply, such as storage. Whilst Bluewaters agrees that these changing dynamics are likely to increase ancillary service costs in the immediate term, Bluewaters has concerns that the cost recovery of these services are non-proportionately skewed towards scheduled generators. The principle underpinning cost recovery for Spinning Reserve, for example, is one of ‘causer pays’. Bluewaters considers the cost recovery methodology has become a blunt instrument, where scheduled generation shoulders the increasing costs of Spinning Reserve and distributed PV bears none, whilst significantly contributing to the quantity required.

The Addendum states that AEMO has increased the Spinning Reserve quantity during times of high PV output (coinciding with lower demand and hence lower scheduled generation output) to account for the increasing risk that distributed solar PV installations have on system security. Bluewaters proposes that increasing the LFAS requirement further during these times instead of the Spinning Reserve requirement would lead to a more equitable market outcome where the cost of this contingency is more evenly distributed among market participants, rather than being allocated under the Spinning Reserve runway methodology, which bears no relevance to the cost’s causality.

Bluewaters also has concerns over the impact that the Minimum STEM Price may have on modelling outcomes. Due to the magnitude of the current Minimum STEM Price (-\$1,000/MWh), there will be disproportionate costs associated with intervals that have cleared at this. The Authority is currently seeking submissions on the first Minimum STEM Price review and has highlighted a number of issues that Bluewaters considers should be included in the Margin Values modelling. Importantly, the Authority observes that for all

instances of Minimum STEM Price between October 2019 and September 2020, the demand forecasts did not reflect the Balancing Price would settle at this price. The price forecast did not provide accurate signals to generators, which may have contributed to prices settling at the Minimum STEM Price. Bluewaters considers a change to the Minimum STEM Price is likely and could take effect from September 2021. Locking in disproportionate impacts of -\$1,000/MWh price intervals into Margin Values could further skew cost outcomes. Bluewaters encourages the Authority to consider limiting the impact of the historical Minimum STEM Prices instances in its modelling of Margin Values, consistent with its observations in the Minimum STEM Price review.

Question 3: Rolling over the 2020/21 values

Due to the limited amount of time that has been allocated to review and respond to the proposed costs provided by the Authority for 2021/22, Bluewaters' position is that the case to roll over the 2020/21 values has merit. The time constraints have meant Bluewaters has been unable to conduct its own modelling and therefore cannot validate the significant increase to ancillary service costs.

Bluewaters also has concerns over the volatility of modelling outcomes that have been published throughout the Margin Values process. The significant differences in outcomes suggest that the causes are not yet fully understood and that further time taken to understand causality would likely lead to a more accurate outcome. This again suggests that a roll-over of the 2020/21 values has merit.

Bluewaters considers that the annual obligation for the Authority to determine Margin Values under the market rules is no longer fit-for-purpose. While it is expected the new Essential System Services market will be adopted from next year (at the earliest), it is unclear whether the Authority, AEMO and Market Participants properly understand the impacts of the changing dynamics of the WEM or the optimal mix of ancillary services required. Additionally, it is entirely appropriate for the allocation methodology of ancillary service costs to be examined prior to the start of any Essential System Services market.

Should you have any questions regarding this submission please contact Dimitri Lorenzo on 08 9261 2826 or dimitri.lorenzo@bluewatersps.com.au.

Yours sincerely,

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