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Ms Sara O'Connor  
Economic Regulation Authority  
PO Box 8469  
PERTH BC WA 6849

Dear Ms O'Connor

### **ERA's review of the Market Procedure: Benchmark Reserve Capacity Price**

The Economic Regulation Authority (ERA) has proposed to limit the scope of the review of the Benchmark Reserve Capacity Price (BRCP) Market Procedure required under clause 4.16.9 of the Market Rules to just the Weighted Average Cost of Capital (WACC) components to ensure that the market procedure is ready for application to the 2021 Reserve Capacity Cycle.

Synergy supports this decision and welcomes the opportunity to comment on the ERA's proposed changes to the WACC component of the BRCP presented at the BRCP Working Group.

In assessing the ERA's proposed amendments to the WACC calculation and associated impact on the BRCP, Synergy has considered the appropriateness of the methodology and resulting values for each of the various input parameters with specific reference to relevant contemporary regulatory precedents (regulated network decisions made by the ERA).

#### **Methodology:**

While the methodology and calculation of input parameters has been heavily debated over the last decade, network businesses and Australia's regulators (the ERA and its East Coast counterpart – the AER) have now largely converged on a consistent approach and associated outcomes. Both regulators have documented these approaches in WACC guidelines<sup>1</sup>.

The ERA has proposed an approach that is largely consistent with the WACC guideline applied in the energy industry, with some parameter updates for the most contemporary decision in the 2020 Weighted Average Cost of Capital for the Freight and Urban Rail Networks and for Pilbara Railways<sup>2</sup>.

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<sup>1</sup> See for example:

<https://www.erawa.com.au/cproot/19968/2/2018%20Final%20Gas%20Rate%20of%20Return%20Guidelines.PDF>

<sup>2</sup> Available at: [Available at: https://www.erawa.com.au/cproot/21399/2/2020-Weighted-Average-Cost-of-Capital-for-the-Freight-and-Urban-Rail-Networks-and-for-Pilbara-Railways.PDF](https://www.erawa.com.au/cproot/21399/2/2020-Weighted-Average-Cost-of-Capital-for-the-Freight-and-Urban-Rail-Networks-and-for-Pilbara-Railways.PDF)

Although the methodology proposed by the ERA is consistent with regulatory best practice, Synergy challenges whether setting a five-yearly WACC in such depressed market conditions, particularly considering the economic impact of COVID-19, is appropriate.

Considering that some of the input parameters are significantly affected by market conditions, Synergy recommends that the ERA:

- 1) Considers the unprecedented impacts to the energy industry and overall economy produced from COVID-19 in its assessment of the WACC input parameters; and
- 2) Introduces a trigger event in the Market Procedure to expedite the re-opening of the WACC should market conditions change significantly such that the WACC no longer remains appropriate.

### **WACC parameters:**

Synergy raises the following concerns for the ERA's consideration:

- **Market risk premium:**  
Synergy does not consider a reduction of the market risk premium is reflective of the general market uncertainty observed in the SWIS and does not support a decrease.
- **Equity beta:**  
Synergy notes the equity beta value of 0.83 could potentially be left unchanged for 10 years if not updated under the current review and questions whether this adequately reflects the risks associated with investing in the Wholesale Energy Market (WEM). Further, changes introduced by the Energy Transformation Strategy set for 1 October 2022 warrants a more frequent review of the equity beta parameter.
- **Value of imputation credits:**  
Synergy does not consider the use of top 50-ASX listed companies reflective of the characteristics of the energy industry and suggests that the existing gamma of 0.25 be retained.

In general, the current WACC does not adequately reflect the current risks unique to the WEM and therefore does not sufficiently compensate investors to trigger new investment. As such, Synergy considers the review of the WACC components both necessary and timely and looks forward to providing further comments in the formal consultation process for the BRCP Market Procedure.

Should you require additional information regarding this submission, please contact Jo-Anne Chan, Senior Regulatory Analyst, at [jo-anne.chan@synergy.net.au](mailto:jo-anne.chan@synergy.net.au).

Yours sincerely



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