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Public Utilities Office
Department of Finance
469 Wellington Street
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via email to: electricitymarketreview@finance.wa.gov.au

Dear Sir/Madam

Design Recommendations for Wholesale Energy and Ancillary Service Market Reforms

Synergy is pleased to provide comment to the electricity market review (**EMR**) steering committee and program office regarding the design recommendations for wholesale and ancillary service market reforms, as detailed in the position paper dated 14 March 2016 (**the position paper**).

Ultimately, Synergy would like to move towards an energy market (electricity and gas) in which it is indistinguishable from other market participants and can actively compete with other energy businesses on a level playing field, including in the already competitive retail gas market. Under the current regime, Synergy is subject to several business-specific obligations and restrictions that do not apply to other market participants. The recommendations contained within the position paper are an important step towards removing some of those obligations or spreading them more fairly and equitably amongst all market participants. Synergy is therefore supportive of the direction and the majority of the recommendations contained within the position paper.

While Synergy is broadly supportive of the concept of facility bidding, if the decision is made to move forward with the requirement for facility bidding, the steering committee should be mindful of the time that will be required to implement the necessary changes. Furthermore, the substantial costs are not, contrary to the assessment implicit in the position paper, incremental. It is essential to consider these time and cost issues when assessing this market reform imperative.

The short consultation period for the position paper combined with the range of possible final outcomes has made it impossible for Synergy to quantify, to a suitable degree of rigour, the time required and the costs associated with implementing the proposed reforms. The fact that the timing and costs of implementation are not known should of itself compel a closer review of this market reform before it is decided.

It follows that Synergy's support of these proposed recommendations, which will necessitate substantial changes to its equipment, systems and operations, is conditional upon funding being available through the state budget process or the market (as the main beneficiary of the proposed changes) and sufficient time being allocated to implement these changes properly.

Synergy's responses to each of the questions contained within the position paper are provided below (in the same order as they appear in the position paper).

Submissions providing feedback on the essential reforms – the implementation of a security-constrained market design, facility bidding for Synergy and co-optimisation of competitive energy and ancillary service markets – are encouraged. (p. 22)

Constrained access

Synergy is aware of the potential benefits of moving to the national regulatory framework and its associated constrained access regime, particularly if the move will result in the full pass-through of the $1.6 billion of network savings recently flagged by Western Power. The move to constrained access may also be beneficial noting:

- excess generation plant already exists in the market;
- physical network constraints are localised and not general;
- a need for new generation in the short to medium term is unlikely, other than renewable energy plant to meet Commonwealth government renewable energy targets; and
- connection of new renewable generation and other assets is likely to be less onerous under a constrained access approach.

Synergy notes other constrained market models may potentially address these issues more effectively. It is unclear whether the steering committee has considered these alternatives at this time. For example, Synergy understands that the National Electricity Market Dispatch Engine (**NEMDE**) may find it difficult to cope with real time loss factors or location pricing. These two issues are however both addressed in the New Zealand wholesale electricity market, which is geographically similar in size to the South West Interconnected System (**SWIS**).

Facility bidding

Synergy requires further information on how the requirement for it to bid on a facility basis will interact with the other obligations in the wholesale electricity market (**WEM**). For example, if Synergy were to believe that its bidding behaviour was related to market power and therefore subject to the requirement to bid at short run marginal cost (**SRMC**), the potential introduction of facility bidding combined with ongoing SRMC requirements and other market power mitigation measures would be unfairly difficult for Synergy.

In order for Synergy to support the introduction of facility bidding, complementary reforms are required that create fair and transparent rules for all participants. Synergy must be indistinguishable from other market participants in the market rules and other legislation and Synergy should have no specific obligations (such as the uncompensated supplier of last resort obligations).

The indiscriminate and selective application of SRMC bidding can lead to other market participants gaming the SRMC bidder. Synergy also believes the competition prohibitions and sanctions under the *Competition and Consumer Act 2010 (Cwlth)* (**CCA**) provide more than adequate principles and remedies to ensure that no market participant unfairly exploits its market power. This approach also then better aligns the WEM with the National Electricity Market (**NEM**).

In practical terms, if the recommendation is to proceed with the requirement for facility bidding, the steering committee should also be mindful of the time that will be required for Synergy to implement the necessary changes. The costs of implementing facility bidding for Synergy will not be an 'incremental' cost as suggested in the position paper. Further details regarding the cost implications for Synergy are addressed later.

Synergy notes that as part of reform implementation, the position paper states that discussions will take place between the Australian Energy Market Operator (**AEMO**) and Synergy to establish whether a reasonable case exists for any co-located generating units to be aggregated for bidding and dispatch. The aggregation of some co-located units and a potential derogation from the requirement to install tariff quality metering could substantially reduce upfront transition costs but could also introduce risks to Synergy. Synergy would welcome further discussion on these options.

The Electricity Market Review proposes later gate closure for the energy and ancillary service markets, five-minute dispatch cycle and ex-ante price determination. Submissions providing feedback on these proposed reforms, including alternative options, are encouraged. (p. 22)

Synergy supports the later gate closure proposal as it will harmonise the closure time for all market participants. The harmonisation of gate closure times is an important step in creating a level playing field for all participants. Synergy also recognises the benefits a shorter dispatch cycle and supports the five-minute cycle proposed in the position paper.

Ex-ante pricing in electricity markets inherently contributes to a downwards bias on prices and undervalues plant availability and flexibility. Such a negative bias will tend to underpay all plant in general, and in particular fast-moving plant responding to generator outages. Therefore, Synergy's preference is to maintain the current ex-post price determination as there is insufficient evidence to support a transition to an ex-ante pricing regime.

Despite this observation of electricity markets generally, Synergy acknowledges that the adoption of the NEMDE is likely to require a shift to an ex-ante pricing regime. Synergy therefore suggests that a hybrid mechanism could be adopted. The hybrid mechanism would allow for situations in which the ex-ante price is manifestly in error (either too high or too low), to be replaced by the ex-post price thereby striking a balancing between the certainty of pricing, and the ability for the market to reflect scarcity accurately.

Submissions providing feedback on the proposed retention of the STEM are encouraged. (p. 23)

Synergy concurs with the conclusion in the position paper that there is currently no case to justify changing the STEM, provided that the costs of retaining the STEM do not exceed the benefits derived from the market.

Submissions providing feedback on the proposal to implement market reforms using NEMDE, a hub-and-spoke network model and single reference node pricing are encouraged. (p. 28)

The nature of the SWIS encourages consideration of locational pricing given the imbalance between load and generation in some parts of the network. Synergy is concerned that the adoption of the NEMDE may preclude ongoing market evolution towards greater location pricing, if desirable, due to its design and capabilities.

The adoption of NEMDE is likely to be a challenge for all market participants and an area of concern. A key risk for Synergy is how its generation units will be expected to interface with the NEMDE. As such, Synergy notes that its ability to meet implementation timelines will depend on the AEMO releasing appropriately detailed technical specifications as soon as practicable. The implementation costs of adopting NEMDE are also not merely incremental. See the later discussion in the submission on costs.

Chapter 4 – General Comments

Synergy supports the retention of adequate constrained-on payments reflecting the principle that a generator that is required to operate out of merit should be fully compensated for its operating costs.

The position paper indicates that under the proposed reforms the financially responsible market participant for a market generating unit would be the person who registered as a generator with the AEMO and classified the generating unit as a market generating unit. The financially responsible market participant would not be required to be the holder of the connection agreement with Western Power for the relevant connection point. However, it is proposed that only the financially responsible market participant for a connection point (and not the holder of the connection agreement with Western Power) should be eligible for capacity credits for the capacity of that generating unit. Synergy supports these reforms as proposed by the steering committee.

On balance, Synergy also supports a single spot price for each trading interval, defined as the time-weighted average of the six five-minute dispatch prices over the 30-minute trading interval. However, it is noted that this arrangement is sub-optimal for peaking generators that are dispatched for periods of less than 30 minutes. Under the proposed arrangements, these generators would, in essence, be providing LFAS services for a price that does not adequately compensate the provider for the service.

Submissions are encouraged from stakeholders regarding whether, and if so how, automatic exemption criteria should be defined for the registration of generating units connected to the South West Interconnected System. (p. 33)

The position paper presents three options to address this issue, including:

1. retaining the current threshold prescribed in the Wholesale Electricity Market Rules (10 MW rated capacity);
2. reducing the threshold in the Wholesale Electricity Market Rules to 5 MW, which would better align with the current AEMO's guidelines while retaining a firm threshold for automatic exemption in the Wholesale Electricity Market Rules; or

3. adopting the National Electricity Market arrangements, under which no automatic exemption threshold would be set in the Wholesale Electricity Market Rules and AEMO would be responsible for the determination of any blanket exemption criteria

Synergy supports the adoption of option three.

Submissions on whether the Wholesale Electricity Market should adopt the National Electricity Market's cost allocation method for system restart ancillary services are encouraged. (p. 45)

Synergy supports the adoption of the NEM's cost allocation method for system restart ancillary services.

With regards to the other ancillary services proposals outlined in the position paper:

- Synergy supports the adoption of the full runway methodology for contingency raise ancillary services (spinning reserve) as it should lead to more efficient dispatch than seen under the current 'modified runway' method.

- If Synergy is to remain the default supplier of ancillary services under the new arrangements the rules should have sunset clauses around these obligations, a rules-mandated review of Synergy's role as ongoing default provider, or a condition that when reached the default provider role falls away (i.e. the condition could be defined as a market share or number of market participants).

- Synergy supports the concept that the costs of spinning reserve and other ancillary services should be market driven. However, there should be no differentiation as to what costs different participants can include in ancillary service offers so as to promote the adoption of the most cost efficient technologies. Synergy does not consider it appropriate to restrict a proportion of cost recovery from certain participants and not others.

- Synergy notes that, similarly to the introduction of the load following ancillary services market, the costs of spinning reserve services will likely increase as the true costs of these services are reflected in market bids rather than via the current regulated pricing regime. At present, any costs over and above the annual margin values calculation are absorbed into Synergy's other operations. In a true market a provider of these services would recover the costs.

Submissions are encouraged on the likely effects on stakeholders of a change to the reference node for the South West Interconnected System from the Muja 330 kV busbar to a network location in the Perth metropolitan region (such as Southern Terminal). (p. 49)

Synergy believes the benefits described on page 48 of the position paper are insufficient to justify moving the nodal pricing reference point from Muja to another location. Synergy is of the view that shifting the reference node to another location (perhaps Southern Terminal as discussed) is unlikely to achieve any real benefits, particularly while an excess of generation exists and the network is not physically constrained.

The proposed change, if approved, may only serve to burden market participants if they have to re-negotiate existing contracts. Indeed, Synergy understands the proposed change is likely to require the renegotiation of most bilateral contracts, which will de-stabilise the existing market and come at a significant administrative (legal) cost.

Synergy believes the appropriate time to transition the reference node from Muja is when the market has matured and diversified sufficiently to support locational pricing.

Submissions are encouraged from stakeholders on the circumstances, if any, under which a formal gate closure limit should apply to generator rebids. (p. 53)

Synergy has limited experience with this issue but notes that in the absence of a formal gate closure, the NEM has set restrictions on rebidding. The approach taken in the NEM is to ensure re-bidding is “in good faith”, with supporting systems that require participants to explain rebids. As a starting point, Synergy would support alignment with the re-bidding requirements that have been recently implemented in the NEM.

Submissions from stakeholders are encouraged on how, and whether, the Non-STEM settlement timelines should be amended. (p. 60)

With a view to minimising administration costs and exposure to cash flow risks Synergy prefers to maintain the settlement on a monthly basis.

Submissions from stakeholders are encouraged on how loss residues collected by the Australian Energy Market Operator, due to the use of static marginal transmission loss factors and settlement by difference, should be allocated back to consumers. (p. 62)

Synergy supports the principle that all retailers should be treated equally and all customers should be allocated an accurate share of the loss residues. In assessing the options proposed in the position paper, Synergy is mindful that it does not have access to a full data set that would enable it to validate the analysis commissioned by the steering committee EMR.

Synergy agrees with the concept of moving towards an alternative settlement approach for loss residues. The alternate methods proposed will not however address all of the current issues associated with loss residues and the notional wholesale meter. For example, any errors in the deemed profile will accrue to either the local retailer or the retailer with the largest number of basic meters.

Further consideration should be given to adopting a “global” reconciliation methodology (similar to that implemented in New Zealand in 2004). Global reconciliation is the process by which any difference between the total electricity supplied to the local network and the aggregate consumption of all consumers within the local network is allocated across those customers in the local network in proportion to their consumption.

As such, under a global reconciliation methodology, settlement would be undertaken by allocating first to generators and all retailers with connection points located within a local area, producing a balance volume. This balance volume, either positive or negative will then be allocated according to an algorithm across all retailers rather than just defaulting back to Synergy (an appropriated algorithm would need to be determined). A global reconciliation approach furthers the argument in the position paper that loss residues will be shared among all consumers rather than allocated to an individual market participant.

Moving beyond the allocation of transmission loss residues Synergy does not understand how the EMR intends to manage the allocation of distribution losses. With regard to implementation timeframes, Synergy believes the changes to the allocation of transmission loss residues should coincide with the introduction of full retail contestability.

The views of stakeholders are encouraged on: what matters should be addressed in the proposed guidelines for interpretation of short run marginal cost bidding obligations under the Wholesale Electricity Market Rules; the types of costs that should be permitted for inclusion in prices offered into the STEM and the new real-time energy market; what matters specific to generators with larger portfolios need to be considered; and how and whether the input assumptions should vary in respect of offers made into the two energy markets. (p. 69)

Synergy is concerned with the implicit assumption in the position paper that market power mitigation measures should remain as is, or be made stronger. Synergy does not consider there is a valid case for the extent of existing market power mitigation measures, let alone stronger measures. On a proper analysis of the factors relevant to the nationally accepted competition principles, the extent of Synergy's market power and its ability to use any market power has been consistently overstated by its competitors. Synergy's ability to compete on an equal basis with its competitors is unfairly limited by the structure of the market and the market rules. In addition highly restrictive market mitigation measures (e.g. ring fencing obligations) were imposed on Synergy following the merger of Verve Energy and Synergy.

Synergy has other concerns with the operation of existing market power mitigation measures within the context of the reforms proposed in the position paper. As noted in the position paper the WEM Rules refers to, but does not define, "short run marginal cost" and "market power". Synergy supports the concerns raised by other market participants about the need for further clarity on how these terms should be interpreted and is of the view that a separate and comprehensive review regarding these matters is required.

Synergy's strong view is the interpretation of market power, within the context of the Wholesale Electricity Market Rules, should be consistent with general competition law. Synergy recommends the steering committee amend the rules to confirm the interpretation of market power should be consistent with Commonwealth statute or case law. The uncertainty caused by applying different competition law principles between the NEM and the WEM results in increased costs to deal with that uncertainty.

If the concept of SRMC is to be retained, Synergy sees that there is benefit in adopting a brief statement of principles which provides greater clarity on items that can be included in SRMC bidding. At the very least, Synergy believes start-up and opportunity costs should be explicitly included in any future guidelines relating to SRMC. Once statement of principles are established, the methodology for setting the market price caps may need to be re-visited to ensure that it appropriately reflects what may be included in SRMC.

The views of stakeholders are encouraged on the feasibility, costs and benefits of early implementation of any of the proposed reforms (p. 74)

Synergy believes changes to the scheduling day processes should be progressed as soon as possible, on the condition amendments do not include significant information technology costs on systems that will become obsolete when the full reforms are implemented.

As a general comment, Synergy believes the EMR should implement transitional compliance arrangements to give participants adequate time to adapt to the new requirements. The moratorium on compliance action for a period of time following the introduction of the balancing market is an example of regulatory reform best practice.

Submissions are encouraged that detail the costs that must be incurred by market participants as a result of the proposed changes. (p. 75)

The recommendations in the paper have been put forward on the basis that they will bring net benefits. However, the paper does not consider the period within which any net benefits may arise nor does the paper indicate the assumptions that underpin an outcome that gives rise to net benefits.

If the government decides to proceed with the proposed changes, it (as the owner of Synergy) will inevitably be required to fund the proposed implementation costs for Synergy. It will therefore be necessary that the government is appropriately informed of the consequences (in particular the financial implications to Synergy) of these proposals. Synergy is currently detailing these implementation costs based on the proposals contained within the position paper. There has been insufficient time for Synergy to determine these costs for inclusion in this response. As a result, Synergy intends to provide advice to the government regarding its implementation costs and ongoing value transfers from the State to other participants under separate cover.

It has been reported to Synergy that the potential cost to the market as a whole of transitioning to facility bidding and dispatch, including a transition away from System Management acting as its dispatch agent, will exceed $40 million[1]. Furthermore, the transition to facility bidding will also require Synergy to upgrade its trading systems and employ additional trading staff.

In addition, the cost to implement the necessary information technology changes to enable the NEMDE is also currently being determined and will need to be budgeted for by the market or the government.

In any case, if the proposals proceed as recommended, these costs will need to be included in the next State Budget Forecast for 2017-2018, regardless of whether Synergy or the market as a whole pays these costs. Given this detailed focus on costs, the government is likely to require a corresponding detailed and rigorously-tested assessment of the benefits.

Synergy also notes the steering committee has requested estimates of development and implementation costs from the AEMO to inform the implementation proposal. This request needs to go further and include estimates of impacts on the market fee rate (including the ERA amendments).

[1] This estimate included substantial capital and ongoing operational costs to Synergy that would be required to support the physical trading of a 30 plus unit generator portfolio and associated requirements and upgraded generator control systems in System Management to support a new operating and reporting regime.

Concluding remarks

Synergy supports the ongoing evolution of the WEM and supports the efforts of the steering committee to achieve greater market efficiency. The adoption of the national framework and market arrangements is supported and will bring long term benefits to consumers.

Synergy applauds the efforts of the steering committee and is pleased with the high quality of work produced by the program office. However, further consideration of existing and proposed market power mitigation measures, as noted above, is required to ensure implementation can be effectively and efficiently achieved.

As was the case with the changes to the reserve capacity mechanism, Synergy stands to be significantly impacted by the proposed changes to the wholesale and ancillary service market. The proposed changes are likely to result in robust debate and further discussion and analysis over the next several months. In particular, Synergy is mindful of the potential impact of these changes on many of its existing contracts and agreements with third parties, some of which are likely to require re-negotiation if change-of-law provisions are triggered.

Based on the proposed recommendations in the position paper, Synergy is currently refining the cost impacts of the proposed reforms. As the proposed reforms are finalised over the next several months, Synergy expects to be in a position to provide detailed final implementation cost advice to government through its normal budget setting processes.

Please contact Mr Jason Froud, manager policy, in the first instance if you require further information regarding Synergy's positions regarding any of these matters.

Yours faithfully

Will Bargmann

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