

Wholesale Electricity Market Rule Change Proposal Submission

RC_2017_06

Call for further submissions: Reduction of prudential exposure in the Reserve Capacity Mechanism

Submitted by

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Submissions on Rule Change Proposals can be sent by:

Email to: rcp.secretariat@rcpwa.com.au

Post to: Rule Change Panel
Attn: Executive Officer
C/o Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

1. Please provide your views on the proposal, including any objections or suggested revisions.

Electricity Generation and Retail Corporation trading as Synergy (**Synergy**) welcomes the opportunity to provide further feedback on Australian Energy Market Operator's (AEMO) Rule Change Proposal: Reduction of Prudential Exposure in the Reserve Capacity Mechanism.

Synergy would like to provide its feedback related to the following questions presented by the Rule Change Panel as requested:

(1) What impact do AEMO's updated cost estimate and this cost-benefit analysis have on your views of RC_2017_06?

Synergy has reviewed the proposed alternative scenario and notes that the proposal has not been fully scoped and developed, the implementation costs are unknown and its potential benefits and impacts have not been fully considered.

In order to determine whether to support this proposal and identify whether the payback period is appropriate, Synergy as well as other Market Participants will require to undertake further financial analysis. To do that Synergy requires the Rule Change Panel (**RCP**) to provide detailed financial data, such as TCI (total cost to implement RC_2017_06), CCS (cost of additional credit support), r (discount rate used in the RCP's calculations) and Synergy's actual prudential exposure under the alternative proposal as estimated by the RCP.

Synergy is also of a view that the time provided for review and consideration of what appears to be a completely new proposal is not sufficient to perform any in depth analysis and financial modelling. We understand that the RCP were potentially looking for some high level views from the Market Participants, however, in order to provide a meaningful feedback, Synergy, and we assume other Market Participants, need to undertake financial modelling based on more detailed data.

Synergy believes that limited data and details that was provided on the alternate proposal and insufficient time to investigate the effects of the proposal, may cause the Rule Participants to potentially double up on some of the work needed as part of this "request for further submissions" and the work that will be required for any future consultation on the alternative proposal. Compounding this issue is that, due to the lack of time, detail and data, Synergy is unlikely to be able to efficiently leverage the work completed as part of this process in any future submissions on the matter.

Synergy also considers that it would be beneficial if AEMO shows which features of the proposals are associated with which costs. For example, Synergy notes that if the costs are primarily associated with removing the n-3 lag, irrevocable bilateral trade declarations could potentially be introduced and remove the prudential risk.

(2) Do you agree with the Panel's approach to the cost-benefit analysis of RC_2017_06?

Synergy has reviewed the methodology of the cost-benefit analysis provided by the RCP and notes that the methodology is based on the assumption that Market Customers provide Credit Support through Security Deposits and bank guarantees (essentially debt), which may not always be the case.

In any event, Synergy is of a view that the use of the Weighted Average Cost of Capital (**WACC**) in the methodology will provide a more accurate cost-benefit analysis for this proposal as it weights each category of capital proportionally rather than just focusing on one category, such as debt.

Synergy notes that in its assumptions for the alternative approach the RCP are also not taking into account bilateral allocations of Capacity Credits between Market Participants for the days in the past for which the allocation window has not yet closed. Synergy would like to stress that if the alternative scenario is chosen, we will need to request more time to assess the implications of the new approach on our operations, bilateral trade arrangements in particular.

(3) What are your per dollar costs of providing Credit Support?

Equal to WACC.

(4) Given the nature of AEMO's investment in systems and your costs to implement RC_2017_06:

a) What do you consider to be a reasonable payback period?

Synergy considers that a 3-5 years is a reasonable payback period.

b) What do you consider to be an appropriate discount rate for use in this cost-benefit analysis?

WACC

General comment

Synergy is of a view that the RCP should consider whether the Alternative scenario can be implemented under the current WEM Rules (for example, potentially under clauses 2.37.5(d) and (i)) and no new rule change proposal would be required. This may potentially reduce the implementation timeframes slightly and reduce the cost.

Synergy considers that the RCP should also explore the extent to which the current Market Rules allow AEMO to assess the need for greater credit support for those Market Participants that it considers are at greater risk of defaulting – this will assist in reduction of overall market prudential exposure while better targeting the costs associated with increased prudential risks to those participants causing the risk (i.e. better reflects an economically efficient "causer pays" approach).