

29 January 2016

Public Utilities Office
Department of Finance
469 Wellington Street
PERTH WA 6000

via email to: electricitymarketreview@finance.wa.gov.au

Dear Sir/Madam

RESERVE CAPACITY MECHANISM POSITION PAPER RESPONSE

Synergy welcomes the opportunity to provide comment to the electricity market review (**EMR**) steering committee and program office regarding proposed changes to the reserve capacity mechanism (**RCM**), as detailed in the Position Paper on Reforms to the RCM dated 3 December 2015 (**the position paper**).

Electricity markets globally are struggling to manage changes to their traditional levels of demand growth and many are currently under some form of review. This includes both energy only markets and those with capacity mechanisms. In Western Australia, a “perfect storm” of contributing factors has made the current EMR review process particularly challenging. These factors include (but are not limited to):

- (a) an overly conservative reserve capacity target (**RCT**) combined with forecasts of increasing load not eventuating, resulting in a large excess of generation capacity;
- (b) a small, isolated grid/market in an area with low generation diversity and a highly variable load profile;
- (c) an electricity industry with a mix of government and private sector ownership with the largest incumbent generation, retail and network utilities remaining in government ownership for the immediate future;
- (d) community expectations of continued high electricity quality and reliability and the media driving perceptions that electricity prices are too high and the price shock of large increases;
- (e) the complexity of the current market arrangements and the vulnerability of the EMR review process to self-serving contributions from industry participants and the gaming of the media and political process, particularly if changes may result in lower returns for participants; and



- (f) the impact of disruptive technologies including renewable generation (subsidised by both the state and commonwealth governments) and expectations regarding the uptake of battery storage technology.

In light of these issues, the Public Utilities Office (**PUO**) and the Western Australian State Government are to be commended for progressing electricity market reform. The current market is unsustainable and the changes that are required in the RCM and other areas of the EMR are long overdue. Synergy is looking forward to being able to participate in the market under terms, conditions and regulations that do not unfairly disadvantage Synergy, which is not currently the case.

The RCM is one of the central elements of the current market design and the importance of properly re-designing the mechanism and transitioning to the new arrangements should not be underestimated. The current mechanism is complicated and the consequences of mistakes in redesigning the mechanism are significant. Furthermore, as seen recently with the radio and newspaper media campaign led by a large demand-side management (**DSM**) aggregator, the debate in this space is vulnerable to being clouded by misinformation for reasons of self-interest.

Synergy stands to be significantly and negatively impacted by many of the changes to the RCM detailed in the position paper. Synergy notes that reductions in the reserve capacity price (**RCP**) in recent years are already having a serious negative impact on the sustainability of the business. However, Synergy does not intend to stand in the way of sensible market reform provided the changes are in the interests of electricity consumers and assist with improving the long term sustainability of the electricity sector.

At the same time, as the only government-owned retailer and generator of electricity in the South West Interconnected System (**SWIS**), Synergy acknowledges it has a very important role to play in helping the government expedite meaningful market reform. However, Synergy must balance this with the need to satisfy its legislative obligation to make decisions and seek market reforms that are in the long term commercial interests of the business.

Any suggestion that excess generation capacity sits within Synergy is misleading and inaccurate. Synergy is a net purchaser of capacity from the market operator. This means it does not have sufficient generation capacity (either owned by Synergy or through agreements with other generators) to meet its own individual reserve capacity requirement (**IRCR**). Given the amount of capacity Synergy procures from the market operator, its existing generation mix is arguably very well suited to the load it is required to serve. Generation plant that has been built and DSM that has been procured purely as a “capacity play” constitutes what should be defined as “excess generation” in this market.

While it will likely be the objective of some other market participants that Synergy absorb the pain of transition to a revised market structure, neither Synergy nor the State Government should be expected to carry all of the burden. Independent power producers have contributed significantly to the excess capacity that is currently in the system and should reasonably contribute to resolving the problem. The costs and consequences of transitioning to a sustainable market must be shared.

This submission briefly examines Synergy’s understanding of the theory and history of the RCM in the Western Australian Wholesale Electricity Market (**WEM**) and the issues with the current approach. It also responds to the proposals articulated in the position paper and proposes a suite of additional issues for further consideration. Synergy’s recommended approach will, in its view, result in a fair transition to a sustainable RCM that will meet the overarching objectives of the EMR.

1. The RCM is not working as it was originally intended to work

While the position paper rightly looks to the future and proposed changes to the existing mechanism, it is important to also understand the context within which the existing mechanism was created and where it has both succeeded and failed.

In its 2002 final report to the then Minister for Energy, the Western Australian electricity reform task force (**ERTF**) argued:

that a gross pool based market, similar to the [national electricity market] NEM, would not be appropriate for the SWIS given the current industry structure, the limited number of market participants, and the lack of diversity and number of generating plants... that a bilateral contract market supported by an appropriate Residual Trading Market [later renamed the short term electricity market or STEM] would be appropriate for the SWIS at its current stage of development.

In essence, the ERTF envisaged that the WEM would predominantly become a physical bilaterally contracted market with the following key advantages:

- (a) reduced set-up costs associated with a bilateral contracts market, when compared to a gross pool National Electricity Market (**NEM**) style market;
- (b) lower price volatility since prices are based on long term contract prices; and
- (c) less ability for market power to influence prices.

The ERTF also supported the creation of a capacity mechanism whereby retailers and loads have an obligation to purchase capacity to meet their actual electricity demand plus an additional reserve margin to maintain reliability in the event of unplanned generation outages or unexpected demand increases.

By creating a tradeable product, later termed a capacity credit, generators and DSM resources would be provided with an added incentive to invest in the market, thus maintaining supply reliability. In addition, by creating a standard product for capacity, smaller retailers would be more able to enter the market to compete against the dominant government owned retailer (Synergy) without necessarily having to build generation plant.

Today, 80 to 85 per cent of energy in the WEM is contracted bilaterally between generators and retailers either explicitly in the form of long term power purchase agreements (**PPA**) or implicitly by retailers actually owning generation plant to meet their electricity needs. Retailers that are bilaterally contracted or who own generation have effectively underwritten generation plant via PPAs or through their decision to build their own plant. When combined with generous reserve capacity payments from the market operator, significant excess capacity (bilaterally contracted and non-contracted plant) has arisen in the market. One effect of this excess capacity is that new entrant retailers are now able to source cheaper energy from the balancing market and cheaper capacity from the market operator without the need to enter into a PPA or make an investment in building plant.

The relatively small size of SWIS (among one of the smallest standalone/non-interconnected deregulated electricity markets in the world) and the lumpiness of new demand and supply has always resulted in some unique challenges for forecasting, regulation and reform in this market. The ERTF had an unenviable task, particularly given the primary objective of the review was:

Sustainable lower electricity prices for all customers while maintaining the uniform tariff for residential and small business customers, and adequate reliability, security, quality and safety of electricity supply.

Given the challenges of accurately forecasting demand in this market and ensuring there is sufficient generation capacity to meet actual demand, the ERTF was faced with the strong likelihood that demand and supply in the WEM would be out of balance (either insufficient or excess capacity) for considerable periods of time.

The RCM was established with a view to reducing (or even eliminating) the very real risk of lengthy periods of insufficient generation capacity. The intention was to establish a framework that would encourage generators to invest in the construction of plant to meet increasing demand. This was achieved by providing new generators with financial incentives and mitigating their market risks.

In this sense, the reforms recommended and subsequently introduced by the ERTF have had success in terms of meeting the following key design objectives:

- (a) enabled competitive retailers to enter the market and compete with Synergy;
- (b) encouraged generation and DSM resources to enter the market;
- (c) maintained high levels of supply reliability; and
- (d) ensured lower spot price volatility in the market when compared to the NEM.

In making its final recommendations to the State Government to introduce a capacity market, the ERTF was no doubt influenced by (then) recent negative experiences with energy markets in the United States (California) and in the NEM (South Australia) in the early 2000s. The overall WEM market design, including the RCM, was clearly intended to overcome problems inherent in market designs at the time such as:

- (a) concerns that governments and policy makers had about the ability of energy-only markets to ensure enough investment to provide resource adequacy and avoid supply interruptions;
- (b) the “missing money problem” whereby market clearing prices for power generation are significantly below average total costs. This is a feature in many energy only electricity markets which results from the distinctive cost structures of electricity generation assets, and has been exacerbated in recent times by near zero variable cost renewable energy; and

- (c) energy-only markets with high price caps providing strong incentives for generators to seek high priced outcomes; in particular, the risk of market power being exercised by generators in those markets and driving up prices through their bidding behaviour.

Unlike energy-only market designs where generators bear most of the market price and quantity risks, the RCM design in the WEM allocates most of the market risks to retailers and customers. Since the commencement of the WEM, the RCM has contributed to a significant oversupply of generation capacity and the cost of this excess capacity is being borne by retailers, customers and (via the subsidy that Synergy receives) taxpayers.

Furthermore, with the recent trend of static or declining demand in the SWIS, it is clear that the RCM has not coped well in terms of reflecting the value of capacity to the market and providing incentives for excess generation to exit the market (i.e. indeed, the existing RCM is proving to be a “barrier to exit”).

In short, while the capacity mechanism has succeeded in maintain high levels of reliability, retailers, customers and taxpayers (via the subsidy that the State Government provides to Synergy) have had to pay for unrequired investment in plant and DSM.

2. Summary of key issues with the current mechanism

The following is an overview of what Synergy considers to be the key problematic characteristics and issues with the current RCM:

- (a) the RCM continues to encourage and credit capacity even when a significant amount of excess generation is present;
- (b) the administered price formula for setting the RCP is insufficiently responsive to market conditions. That is, even when capacity is not required, the mechanism still sets a price that encourages new plant entry or the aggregation of DSM resources;
- (c) when the RCM was established, it was never intended that the administered RCP would become the “default” capacity price. This appears to have eventuated, however, due to the absence of (or lack of need for) a capacity auction;
- (d) the administered price provides a guaranteed revenue stream for existing plant. Provided that the revenue from the RCP and energy sales exceeds a plant’s variable and fixed operating costs, it is worthwhile retaining the plant even in an oversupplied market;
- (e) the market operator does not specify the type of generation capacity required in the market, instead equally accrediting all types, potentially resulting in a sub-optimal mix;

- (f) the current rules do not allocate different payments for different types of capacity. For example, DSM receives the same capacity payments as generators in return for the prospect of reducing their demand when required. This is despite not having to bear similar capital and operating cost and reliability requirements;
- (g) most of the market risks are borne by retailers, with the result that investors in new generation plant are able to transfer asset-stranding risks to retailers, particularly Synergy;
- (h) the market operator effectively underwrites new investment without new generation entrants having to enter a bilateral contract with a retailer or large load customer. Any over-investment in generation capacity that contributes to lower wholesale prices is then faced by market generators and retailers. This encourages market participants to further reduce their level of bilateral contracting to avoid being out of the money on contracts that include capacity; and
- (i) any supply or demand resource that can establish itself as “committed” and declares itself as intending to trade bilaterally (whether or not it ever actually enters into a bilateral agreement) can secure capacity credits and receive the RCP. The certification process and the eligibility of an investor to be paid for capacity credits are not affected by the quantum of excess reserve capacity.

The RCM cannot be considered in isolation. The flow on effects of the current oversupply in generation capacity also has an impact on the sustainable working of the energy market. To illustrate this point further, Synergy notes the WEM currently has ~11 per cent excess generation capacity (including DSM); additionally the generation sent-out mix in the WEM is predominantly baseload and renewable generation (coal, baseload gas, renewables and associated load following) which is not necessarily optimal for the load shape of the SWIS. After Synergy’s retirement of Kwinana C last year, the SWIS contains 2,550 MW of base load capable generating capacity.

The low growth in underlying demand which is exacerbated by the growing penetration of small-scale renewable generation, investment in large-scale renewables (~500 MW) and associated load following has led to an excess of low variable cost baseload generation. This leads to downward pressure on balancing prices (compared to an optimised portfolio mix), with average balancing prices in the SWIS now roughly aligning with baseload generation short-run marginal cost (**SRMC**) due to the infrequent and low level use of higher cost peaking plant.

In an excess generation capacity position as is the case in the SWIS, generators are receiving a low capacity price aligned to a peaking generator. However, energy revenues are also suppressed at many times to the SRMC of baseload generation, thus providing little or no margin for baseload generation to offset larger fixed costs at the resulting market prices.

For Synergy to remain competitive in the contestable market, customers are charged a capacity price that is reflective of the market operator’s RCP (i.e. based on low fixed cost/high variable cost peaking generation) and the energy price is based on the balancing price (i.e. based on high fixed cost/low variable cost baseload generation). Thus, contestable customers are benefiting significantly from the surplus generation in the WEM. In an ideally functioning market, customers would be paying costs closer to the long-run marginal cost of generation.

In the WEM, the majority of baseload generation is either owned by Synergy or contracted to Synergy via PPAs. Synergy's PPA costs were set to ensure that the counterparties made a viable return from their generation and are not reflective of the current market prices. It follows that the costs Synergy has to pay its counterparties are significantly higher than it can receive from contestable customers in the current market, due to those customers having access to the lower cost option of the Independent Market Operator (**IMO**) capacity prices and balancing market energy prices. The proposed changes to the RCM, particularly if they result in a further reduction in the RCP, will exacerbate these issues. In well-designed markets without very large excess capacity, these risks are a normal part of business, but in the WEM it means Synergy is being made to incur costs due to the market design flaws and over-investment decisions of other parties.

3. Summary of Synergy's positions

Synergy is mindful of the time constraints that have been imposed on the entirety of the EMR reform process and is concerned that this may result in an incentive to only make incremental changes to the market design or result in changes that are sub-optimal. Synergy is supportive of priority being given to ensuring changes are made that facilitate material improvements in the RCM and other EMR initiatives, with timing constraints being a secondary consideration.

Synergy also recommends a 1 October 2018 start date for changes to DSM market participants and their customers to align curtailment plans, in line with the proposed harmonisation of DSM and integration of existing real time telemetry with system management.

With a view to ensuring an enduring and sustainable market, a further principle in the capacity mechanism reform process should be a bias towards free market design. Wherever possible, market forces and market dynamics should be allowed to drive outcomes and the market should be allowed to send price signals that result in changes (if required). If the design of the mechanism is rigorous and sustainable, regulatory or political intervention is less likely to be necessary resulting in increased certainty for all market participants.

A number of potential reforms exist that would make the pricing of capacity more responsive to demand/supply conditions. However, under any arrangements that eventuate from this process, it is important that capacity prices more rapidly adjust to better reflect the value of capacity.

In Synergy's view, requiring all retailers to bilaterally contract for a significant majority of their capacity and energy is the best option. Given this is how the market was originally intended to operate, minimal changes to the current arrangements would be required, but this approach is also compatible with the mechanism proposed in the position paper. A downside is that requiring all retailers to bilaterally contract to a certain level of their IRCR (perhaps to POE50 levels) will have a disproportionate impact on some existing market participants, particularly those retailers and generators who are not already bilaterally contracted or do not own generation plant.

Retaining a capacity obligation on retailers and loads and requiring bilateral trading between retailers and capacity providers will help to rapidly reduce over-supply of capacity and energy. The capacity obligation (IRCR) for retailers should still be set along the same lines as the current mechanism, however, as retailers would only want to pay for capacity that they require to meet their share of the RCT, it is unlikely they would commit to significant excess capacity.

Under the proposed mechanism, retailers and generators would also be acutely aware that any overbuild of plant could impact wholesale market prices, so would be sensitive to both the amount and type of plant or DSM that is contracted. However, this process is clearly susceptible to (real or perceived) market power issues which will need to be investigated further prior to decision and implementation.

Synergy acknowledges the value DSM aggregators and their customers can provide in an optimally designed electricity market. An active DSM product allows both retailers and their customers to optimise their IRCR obligations while contributing to the economic objectives of a sustainable and efficient RCM.

Synergy is also firmly of the view that significant benefit would be derived from removing DSM from the RCM altogether and either appropriately pricing it as an ancillary service or allowing retailers to procure it separately to meet their IRCR and peak energy demand obligations. This would allow retailers and DSM providers to negotiate an appropriate value for this service. Synergy sees no reason why a market based approach to DSM would not work.

4. Reform objectives and principles

- (a) Synergy broadly supports the reform objectives and principles contained on page 9 of the position paper. Other than noting that dot point three under “Objectives” seeming to be a partial duplication of dot point two, Synergy does not have any further comment regarding the objectives of the proposed reforms.
- (b) With regard to the principles of the proposed reforms, Synergy agrees that the capacity price should reflect the economic value of the capacity. With this in mind, Synergy is of the view that different types of generation plant provide different value. Further consideration should be given to introducing systems that provides for different types of capacity to receive differential levels of capacity payments.

5. Comments regarding proposed features of the pre-auction (transition) mechanism

- (a) Synergy agrees with the concept of a transition period to a capacity auction. With the current level of excess capacity in the market, if the market were to be moved to an auction immediately it would cause the capacity price to trend towards zero, resulting in catastrophic financial shock for many market participants. Such a decision would severely erode the confidence of the industry in the EMR process and would result in increased short term uncertainty.

- (b) Synergy supports moving to an auction when a forecast of 5 per cent excess capacity will have effect (through plant retirement or load growth, or a combination of both). The committee should not consider a forced move to an auction after a pre-determined period of time. While the setting of a “first auction year” would increase certainty about when the auction will commence, doing so will not encourage market participants to retire generation plant during the transition period.
- (c) Synergy agrees with the proposed position to retain one excess capacity adjustment slope during the transition period prior to a capacity auction. This will provide increased certainty to industry participants and investors.
- (d) The steepness of the proposed excess capacity adjustment slope (-5 per cent) is supported. While the steepness of this slope will likely result in lower reserve capacity price in the short term (which is detrimental to Synergy), it is acknowledged that the steeper slope will encourage a more rapid transition to more balanced capacity market.
- (e) Synergy disagrees with the statement in the position paper suggesting that Synergy should retire some of its generation plant. With a steeper slope for the capacity market, both Synergy and independent capacity providers should make their own commercial decisions about when to retire plant. Synergy also notes that although Synergy may have ageing plant, it is not “inefficient” and is indeed likely to be the lowest cost energy providing plant in the SWIS. Additionally, Synergy notes that the removal of some of its low cost generation facilities will likely lead to higher energy costs, which is contrary to the EMR objective to provide “least cost, sustainable delivery of capacity and energy to customers”.
- (f) Synergy disagrees that DSM should be included in the excess volume and RCP calculations during the interim (pre-auction) period. DSM should be removed from the RCM entirely during the transition period and priced separately as it provides a fundamentally different service to physical generation facilities. Further to this, Synergy is of the view that DSM should not be reintroduced into the RCM when the auction commences. DSM should be a retailer procured product that does not receive separate capacity payments, or alternatively, is used as an ancillary service.
- (g) In the event that DSM is not procured by retailers and instead receives an administered price during the pre-auction period, it is still important that that the price paid for DSM is reflective of the value it provides. With this in mind, Synergy notes the proposed amount to be paid to DSM during the transition period is the same as the NEM cap price (\$13,800/MWh). The position paper also refers to the value of customer reliability (**VCR**) review that was conducted by the Australian electricity market operator, which described a range of VCRs for various load sectors that range between \$47,670/MWh to as low as \$1,440/MWh for some direct connected customers. The average VCR in the NEM (including direct connect customers) is \$33,460/MWh. At an energy (price for dispatch) payment capped at \$13,800/MWh, Synergy is of the view that there will be no incentive for DSM participation based on the opportunity costs being too high. A value closer to the NEM VCR average for energy would more reasonably reflect VCR values for different industry types in areas where DSM is more likely to be needed, and would ensure DSM remains relevant in the system.

- (h) Synergy is concerned that the interim DSM fixed payment of \$13,800/MW is inclusive of 4.9 hours of DSM participation (including the one hour annual verification test) as outlined in section 7.2 additional considerations. All DSM that is dispatched should be paid an energy payment close to the average VCR. Synergy supports a mechanism for an efficiently priced availability payment (or equivalent) which covers the cost for undertaking annual verification tests and an effective dispatch price that will allow optimised DSM portfolio's operating under the proposed harmonisation and transition pricing structure.
- (i) While Synergy agrees with the notion that all DSM must be sold to the market operator during the transition period (as is the case now), when an auction is triggered, it is Synergy's preference that DSM not be included in the RCM, but is instead separately procured by retailers.

6. Comments regarding proposed features of auction mechanism

- (a) There is a reasonable scenario that an auction may not be required for many years due to high uptake of battery storage creating load shifting and solar photo-voltaic rollout continuing to result in reduced system loads. The steering committee and the program office should consider this scenario and how it would manage a very long term "transition" period. As described above, Synergy does not support a forced auction after a defined period of time.
- (b) Synergy is keen to further understand and participate in discussions regarding the shape and positioning of the proposed auction demand curve including the auction price cap, the zero crossing point and the inflection point. It is noted that the shape of the proposed curve in the position paper is convex and flat and steep linear curves have also been considered. Synergy would like to see further exploration and discussion around the benefits of a concave curve in this market which, depending on the positioning of the curve, would result in less price volatility before reaching the 5 per cent excess capacity "target" and much higher price volatility beyond that point.
- (c) Synergy agrees with the PUOs suggestion (from further discussion) that a five year recalibration of the auction demand curve is appropriate. Too frequent calibration (including positioning and shaping) of the demand curve would decrease certainty in the market and could also reduce the likelihood that the market finds the most efficient solution.
- (d) While the paper is silent on the matter, Synergy supports all generation plant being able to participate in the energy market regardless of whether it is successful in being cleared in the reserve capacity auction. In other words, the right to participate in the energy market should not be dependent on being cleared in the capacity auction.

7. Other auction matters

- (a) Synergy understands the PUO is intending to introduce an auction that is a gross capacity auction where bilaterally contracted and gentailer capacity is required to bid but all other capacity that is cleared in the auction would receive the auction clearing price. Synergy would like to further explore the finer details and practical consequences of the proposed auction with the steering committee.

- (b) Synergy supports a three year forward period between when the auction is held and when resource commitments are determined. However, Synergy notes the argument for that period is in part based on the timeframes expected for the development of new peaking generation resources. Given proposed new network access arrangements in other areas of the EMR, development timeframes for peaking plant could change.
- (c) While the position paper has proposed a delivery period of one year and has explained the reasons for this, Synergy would encourage the steering committee and the program office to further consider the risks and benefits of a longer (perhaps variable) commitment periods in the currently oversupplied market. The committee should also consider differential commitment period for different types of generation that better reflect the physical and operational aspects of that type of generation.
- (d) Synergy supports the proposal for a simple, single-round sealed bid auction format.
- (e) Synergy agrees that the implementation of measures to mitigate market power should be adopted at a level that does not constrain efficient market outcomes. Synergy and other parties should still be able to operate in a sustainable and commercial manner and make commercial decisions regarding plant operations and retirements.
- (f) Synergy is keen to be involved in the design and development of the supplementary capacity procurement process. If not done well, this supplementary process has the potential to seriously undermine the annual auction process.

8. Reforms to capacity availability

Synergy does not agree with the proposal to implement the scheduled generator availability incentives proposal, as originally developed by the IMO, with minimal changes. The final proposal (following two rounds of participant submissions) was to:

- (a) allow more flexibility in assigning a reduced quantity of certified reserve capacity (**CRC**) (between zero and full allocation) to scheduled generators that display excessive outage rates over a 36 month period (current 30 per cent combined outages rule declining to 20 per cent over five years);
- (b) impose an upper limit on the number of trading intervals in a 1,000 trading day period for which a generator can receive a reduction of its reserve capacity obligation quantities due to planned outages; and
- (c) provide discretion to require performance reports from a market participant concerning a scheduled generator with an excessive planned outage rate over a year, regardless of the availability of total system capacity.

Synergy does not consider it necessary, or efficient, to have three different measures of “excess” unavailability levels over three different timeframes with different penalties. The additional monitoring obligations will lead to additional, unnecessary costs for market generators (which will be ultimately passed onto end users). Further, the additional complexity for the market operator to also monitor three different measures does not seem warranted.

The IMO's proposal was an over-reaction to a set of circumstances in the WEM at the time. The outage rates displayed by some facilities were entirely within the bounds of the market rules (as drafted) and, in part, were an outcome of the excess capacity in the WEM. In approving planned outages, system management needs to ensure sufficient margin is available to ensure system security can be maintained – as such, if the facilities had been needed, system management would simply not have approved the planned outages. Given the proposed transitional amendments to the RCM to reduce the levels of excess capacity, system management will not approve planned outages where there is insufficient spare generation to do so.

Finally, Synergy considers that the natural and, very strong, incentives to be available in a predominantly bilateral contract market coupled with the proposed dynamic refunds and refunds recycling regime will provide sufficient incentives for availability and reliability.

While Synergy does not agree that the availability incentives proposal is at all necessary, should the steering committee decide to proceed, Synergy urges the committee to consider implementing a subset of, and/or modification to, the measures outlined in the proposal including:

- (a) removing the IMO's ability to certify a quantity of CRC between zero and full allocation;
- (b) refining the proposal to reduce the combined planned outage rate and forced outage rate thresholds that trigger clause 4.11.1(h) to allow market participants to adjust their behaviour and for that behaviour to be reflected in the corresponding measures;
- (c) allowing for a regular review of the outage criteria to apply under clause 4.11.1(h) and the refund exempt planned outages cap rather than the proposal to undertake a one-off review by 31 December 2018;
- (d) removing the discretionary power for the market operator to request a performance report and a performance improvement report(s) or both from facilities with planned outage rates over the prescribed threshold, due to the creation of unnecessary regulatory burden;
- (e) if retaining the proposal for the market operator to request a performance report or performance improvement report(s), then increasing the threshold before it can do so and including explicit timing requirements for the performance improvement report(s);
- (f) all market participants paying their fair share of any costs incurred by the market operator for an opinion on a performance report or performance improvement report(s); and
- (g) including an appropriate governance framework around the market operator's ability to further reduce the cap on refund exempt planned outages, due to the undue regulatory risk the proposal placed on participants.

Synergy would welcome further discussions regarding this matter if required.

9. Dynamic refunds (link to availability incentives)

Notwithstanding Synergy's position that the above availability incentives proposal is unnecessary, Synergy is concerned that the availability incentives proposal has not been adequately considered alongside the dynamic refunds proposal (both of which provide incentives for generators to maximise their availability).

While Synergy is generally supportive of the dynamic refunds proposal, it is concerned there is additional and undue risk for market generators that have facilities above the refund exempt planned outage cap who make a decision to undertake further planned outages.

The IMO has rightly recognised that a rational market participant would not risk the high costs of plant failure by failing to undertake necessary maintenance, even where a facility has reached the proposed cap on refund exempt planned outages. A rational market participant would appropriately schedule this additional maintenance for a time when there is sufficient margin available to ensure system security can be maintained.

However, under the proposed dynamic reserve capacity refund regime, the market participant – despite having scheduled its maintenance at an appropriate time - may now be exposed to a far higher refund factor resulting from unforeseen supply interruptions. Synergy considers that this is not the correct outcome for the market participant who has acted appropriately by scheduling its maintenance at a time that was deemed suitable for the market (via its approval from system management).

It has previously been stated that the proposed dynamic reserve capacity refund regime is “expected to strengthen the incentives for maximising the availability of capacity in the energy market through efficient scheduling of maintenance...and reducing the risk of price spikes in the event of unforeseen supply interruptions¹”. Synergy considers that the market participant that schedules its maintenance appropriately (i.e. a planned supply interruption) and has the necessary approval to undertake that maintenance at that time, should not be penalised at a higher rate due to other unforeseen supply interruptions.

If there is a penalty for taking planned outages over the proposed cap, Synergy does not consider that the proposed penalties are appropriate.

10. Capacity refunds should be paid to retailers

Synergy is of the view that capacity refunds should continue to be paid to retailers. Retailers pay for an expected (administered) quantity of capacity. If this capacity is not available, retailers are impacted by temporary increases in balancing prices, which will become increasingly volatile as the amount of excess capacity in the market decreases over time. It is appropriate that retailers continue to be compensated for this through the capacity refund mechanism.

If the steering committee does not agree with this proposal, and instead believes that refunds to generators will further incentivise them to be available, Synergy would prefer that refunds are only paid to generators that have been dispatched on the day in question, not their availability as proposed.

¹ Page 2 of the IMO's Rule Change Notice for RC_2013_20: Changes to the Reserve Capacity Price and the dynamic Reserve Capacity refund regime.

11. Concluding remarks

As the largest bilaterally contracted retailer and generator in the SWIS, Synergy stands to be significantly impacted by the proposed changes to the RCM. 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 may require re-negotiation if change-of-law provisions are triggered.

Despite the challenges that lay ahead, Synergy looks forward to the finalisation of the proposed changes to the RCM and is hopeful that the revised mechanism will be a fairer, lower cost and sustainable model that is well suited to the small and isolated nature of this market. 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

JASON WATERS
CHIEF EXECUTIVE OFFICER