

## Submission in Response to ERA Public Consultation

### Effectiveness of the EGRC Regulatory Scheme

#### Standing

Community Electricity is:

- a a licensed Electricity Retailer and a provider of Electricity Retail Services and Market Consultancy;
- b a member of the Independent Market Operator's Market Advisory Committee;
- c a member of the Economic Regulation Authority's Technical Rules Committee;

Further information is available at: [www.communityelectricity.net.au](http://www.communityelectricity.net.au)

#### Executive Summary

Community Electricity considers the Standard Products to be dysfunctional and flawed in their conception because of the asymmetry between a seller foregoing pricing upside and a buyer seeking insurance from pricing downside. As demonstrated in this submission, through the operation of the buy –sell spread, sellers to Synergy have to pay a premium in order to receive a price materially below what they expect to obtain from the WEM – plus, they have to forego the potential upside that ensues when a Synergy generator breaks down, being a frequent occurrence. Consequently, the Buy – leg of the pricing spread is economically irrational.

Conversely, a buyer would pay a premium for insurance against occurrences that are excluded by onerous Force Majeure provisions.

From the retailer perspective, the potential utility of the Standard Products is through the provision of risk management services and not the provision of wholesale energy. Wholesale energy can already be very cost-effectively sourced from the Wholesale Electricity Market without quantity and profile risk (that is, in exactly the required quantity at exactly the required time). The proof of this is that the several recent entrant retailers all operate this model.

We perceive that the proper role of Synergy's Standard Products is in the provision of risk management services as a hedge against energy price volatility. We further consider that the principal cause of this volatility is Synergy's maintenance strategy and operational performance, as evidenced by the ERA's investigation of energy price peaks a few years ago. The 'competitive neutrality' objective therefore requires careful design and limitation of Synergy's Force Majeure protections, which we consider are currently unreasonably broad and obscure to the extent of constituting a de-facto put option in Synergy's favour. Restricting Synergy's Force Majeure protections is central to improving its efficiency.

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Community considers that the ring fencing and non-discriminatory aspects of the Standard Products are ineffective and superficial. Synergy's competitive advantage resides in the transfer pricing provisions for its Foundation Customers, which are supplied on the basis of the average portfolio price with full insulation from Force Majeure Events. The 'non-discriminatory' objective applies only to the incremental energy component and actually preferentially benefits Synergy's Retail Business Unit by enabling and justifying it to take supply from the WEM instead of the Wholesale Business Unit. While this takes place ostensibly on the same terms as for the private sector, the RBU is insulated from the potential consequences of energy price volatility by the Government operating subsidy.

On the basis of this advantage, Synergy has been aggressively cutting prices in recent months and is successfully retaining market share, even in the traditionally neglected Small Use Customer segment. We consider that this is taking place without regard to the implications for the operating subsidy, and we predict that the subsidy will increase accordingly as revenues are being reduced and costs maintained.

We recommend that at a minimum the Standard Products should include the Off Peak component that is already implied in the existing design, and the Force Majeure definition should be restricted so that Synergy bears the consequences of its maintenance strategy and plant reliability. We further suggest that the obligation to offer a Buy – Sell spread be relaxed so as to facilitate products tailored for buyers, and that such a product should principally be 'event based' rather than seasonal. For example, both the utility of the products and Synergy's efficiency would be enhanced if a sell-product was tied to Synergy's winter maintenance – of which the planned 80 day outage of Muja 6 is an example.

Further suggestions for improvements are also made.

## SUBMISSION

### The Standard Product Scheme

The Standard Products Scheme is characterised as follows:

- Buy & Sell price pairs separated by a spread;
- Peak & Flat profiles according to the traditional Peak definition;
- Supply Periods of calendar quarters, calendar years and Financial years;
- Minimum quantity of 1MW;
- Maximum quantity of 5MW per week;
- Force Majeure provisions that entitle Synergy, at its option, to claim relief from its obligation to supply in a broad range of circumstances;
- Application to become an Approved Counterparty requires provision of the most recent 2 years audited financial statements;

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- A Credit Policy that requires a formal credit assessment to be performed annually on all Approved Counterparties that consume more than \$100,000 of energy per year, regardless of whether the Counterparty settles by cash pre-payment.

## Electricity supply from the WEM

The alternative to consuming a Standard Product is to transact – buy or sell - from the Wholesale Electricity Market at the 30-minute Clearing Price set by price-stacking generators – including Synergy – compulsorily bidding at their respective Short Run Marginal Costs. The WEM also automatically transacts the precise quantity of energy required at the precise time it is required, and automatically adjusts this quantity retrospectively as and when meter data is updated and corrected.

Electricity purchases from the WEM are also subject to simple and fit-for-purpose prudential requirements without inappropriate intrusion into the participant's affairs.

## Interrelatedness of the WEM and Standard Product Prices

It should be noted that as Synergy is the dominant generator and also controls several important private generators, it also dominates the WEM price stack and consequently the WEM prices. Insofar as the Standard Products are 'honestly' priced, their Buy – Sell mid-points should, therefore, be representative of the WEM price and there should be a reasonable correspondence between the evolution of both.

While the historical WEM price compares favourably with the Standard Products on the average over long periods, it exposes the offtaker to price uncertainty in the short term. The potential merit of an offtake from Synergy is therefore as a hedge against price volatility, for which the offtaker pays a premium and takes quantity risk.

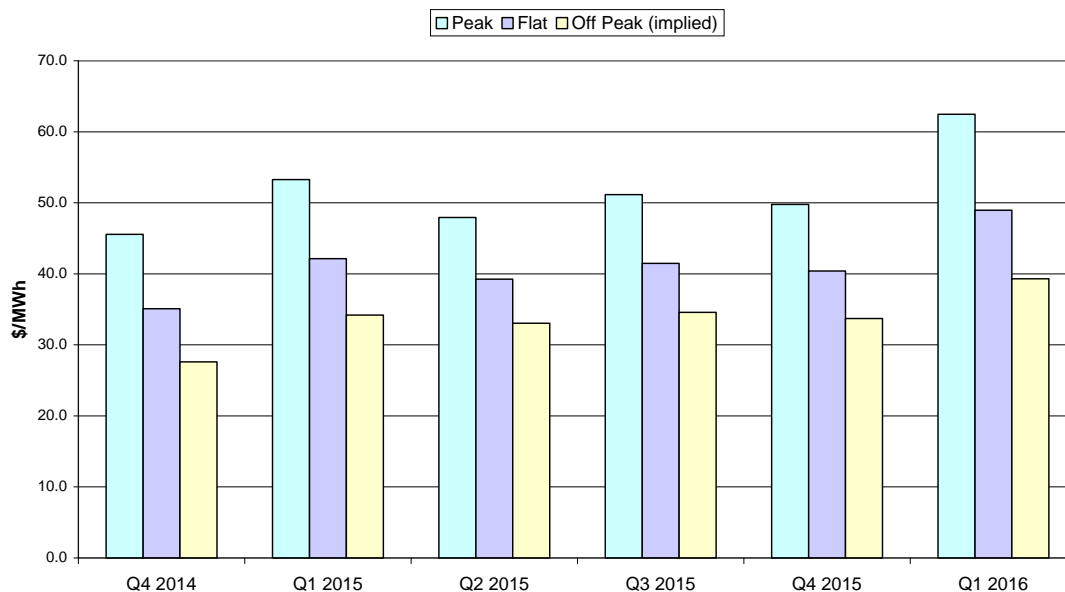
## The Standard Product Prices

The mid-price quarterly evolution is shown below. Given that the Force Majeure provisions protect Synergy from price increases arising from plant breakdown, we consider that these prices are unreasonably high and are reminiscent of a belt-and-braces contingency for plant breakdown that is presumed to somehow elude the Force Majeure protection.

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Quarterly Energy Prices - Standard Products "Buy - Sell Mid-Point"



We reiterate that the appropriateness of the Standard Product prices is best assessed by comparison with the WEM prices. The Q1 comparison is especially important because the Wholesale Market Rules 'penalties' for generator breakdown are highest during this period, so that the generator fleet is at optimum reliability.

The substantial increase in the Q1 2016 prices relative to Q1 2015 should be noted and in the interests of transparency should be explained.

## Assessment of the Q4 2014 products

Because of the newness of the Scheme and the complexity ensuing from the retrospective removal of the carbon tax, the products for the (incomplete) current quarter are the only prices that may be reasonably assessed.

The Standard Products – Sell and Buy for Q4 2014 (which period is not yet concluded) are shown in the respective figures below and compared with the WEM price up to 17 December, being the most recently available data. We note that this assessment period included substantial maintenance disruption as shown in the following screenshot of the IMO's outage tool.

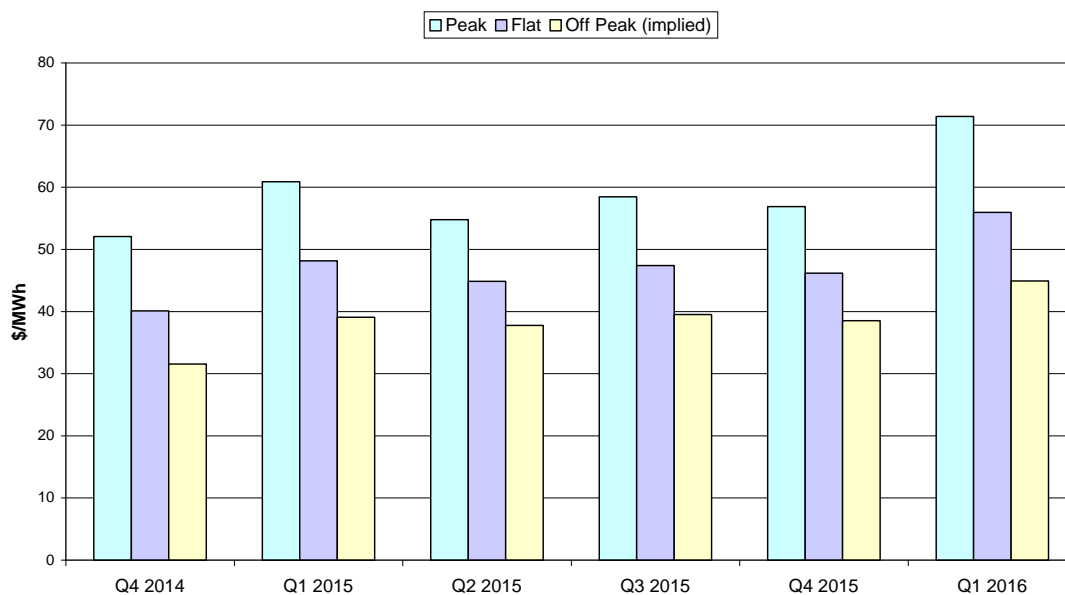
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## Synergy - Sell

Quarterly Energy Prices - Standard Products "Sell"



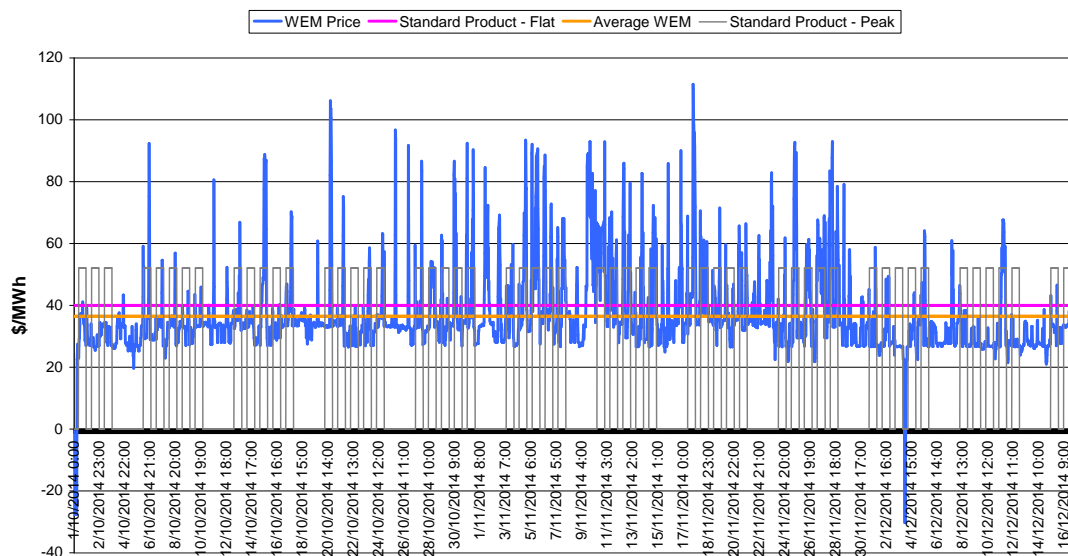
The price progression of the Standard Product – Sell prices for Peak, Flat and inferred-Off Peak are shown in the chart above.

The Q4 2015 Synergy- Sell products are compared with the WEM Balancing Price below.

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**Comparison of Synergy Standard Products with the WEM Price -  
"Sell" Q4 2014**



The figure demonstrates that, conditional on the Force Majeure provisions not having been triggered, the Flat Standard Product during the period was very good value – as prices could have been a lot higher due to the relatively high quantity of maintenance. The WEM Flat Price of 36.5 \$/MWh compared with the Standard Product Flat – Sell price of 40.1 \$/MWh - a 9% premium. In contrast, the Peak – Sell price premium was 30%, corresponding to a WEM price of 40.0 \$/MWh compared with 52.1 \$/MWh for the Standard Product.

We note that Synergy sold 10MW of Flat, but there is no indication of the buyer and whether the Force Majeure protection was claimed.

## Synergy- Buy

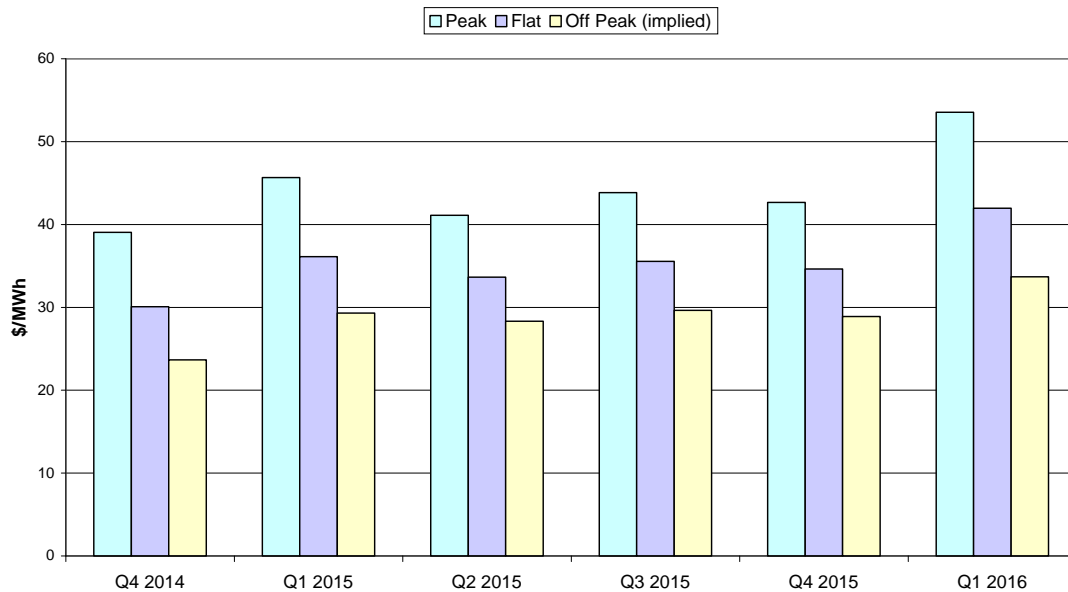
The following charts show the evolution of the Synergy – Buy prices and also a comparison of the Q4 2015 Synergy- Buy products with the WEM Balancing Price.

In contrast to the Synergy - Sell product, the seller of the Synergy – Buy product foregoes the potential upside of energy price volatility. In this case, the flat buy price is 30.1 \$/MWh compared to the average WEM price of \$36.5 – a premium (discounted price) of 17%. The Peak-Buy price is \$39.1 compared to the average WEM peak price of \$40.0 – a premium (discounted price) of 2%. This means that a seller to Synergy must be willing to accept a slightly lower price from Synergy than it can reasonably expect to obtain from the WEM whilst also foregoing the potential windfall gains that ensue from breakdown of a Synergy generator. Noting that Synergy offers no credit standing advantage over such a short and immediate period, we suggest that the Synergy – Buy product price is economically irrational. Consequently, the pricing discipline that depends on a Buy – Sell spread is dysfunctional.

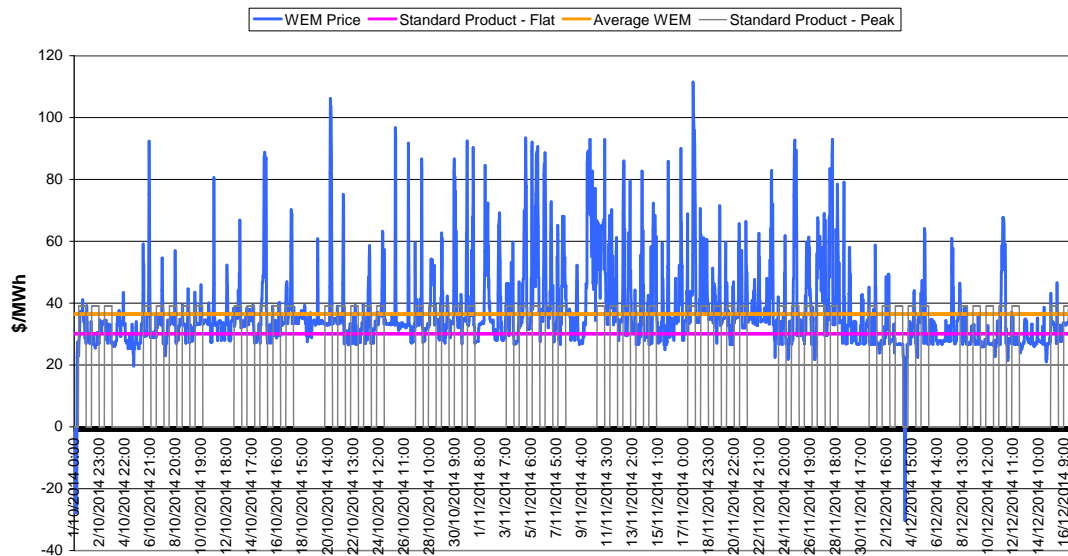
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**Quarterly Energy Prices - Standard Products "Buy"**



**Comparison of Synergy Standard Products with the WEM Price - "Buy" Q4 2014**



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- iii price increases are far more likely to occur than price decreases because of the likelihood of plant breakdown and fuel price increases; no new plants are due to commence and fuel prices are trending up rather than down;
- iv a buyer from Synergy buys the certainty (subject to Force Majeure) of avoiding price increases and forgoes the opportunity of benefiting from price decreases;
- v a seller to Synergy foregoes the opportunity of benefiting from price increases, and is paid considerably less than it could reasonably expect to achieve from the WEM;

On this basis, it is plainly irrational to take up the Synergy – Buy product and so this concept cannot act as a counter-lever in balancing the Standard Products.

We further note that ‘liquid’ sellers to Synergy don’t exist, and even if they did, Synergy can easily absorb any financial exposure on a block of 5MW, even without the backstop of the Operating Subsidy.

## Alternative form of Price Discipline

We suggest that a preferred form of ‘price discipline’ is already be inherent in the assessment of the value of the Standard Products relative to the WEM price – that is, the inferred price of the corresponding (but not offered) Off Peak product for Q4 2014 would have been 31.6 \$/MWh compared with an actual WEM price of 34.0 \$/MWh. While we recognise that the negative premium (being an advantage to the customer) might have more to do with circumstances than design (indeed, Synergy’s Forced Outages and the increased Spinning Reserve requirement while it re-commissions plant), we suggest that this is evidence of inappropriate pricing and in the interests of transparency needs to be explained. In particular, it should be remembered that the Off Peak product is not offered.

We also note that the inferred Off Peak Price for Q4 2015 is \$38.5, being an increase of 21% compared with an 8% increase in the equivalent Peak price. We suggest that this also needs to be explained.

## An Off Peak product – a simple way to improve pricing efficiency

We suggest that Synergy should be compelled to offer an Off Peak spread because on the face of it, it would be profitable for a retailer to ‘rebalance its portfolio’ through Off Peak sales. We consider that this could be done at no incremental administrative cost and, we would ourselves be interested in taking up such a product conditional on reasonable Force Majeure provisions and remaining unmolested by the unwarranted privacy intrusions, as described below.

## The Buy – Sell spread

We consider that the practical consequence of the requirement to offer a spread is to constrain Synergy in the products that it can reasonably sell because of the theoretical possibility (real or imagined) of creating a corresponding risk exposure. For example, we would welcome the ability to buy a 5 hour block of energy, but perceive no merit in compelling Synergy to offer to buy a corresponding block.



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## Prediction – Q1 2015

In forming a view of the WEM price over Q1 2015, we note that there are currently no material outages planned. More generally, the Market Rules heavily penalise Forced Outages over this period – being the Hot Season - and thereby encourage generators to be in optimal condition.

While data for December are available up to only the 17th, we note that the flat price over this time was around 30.5 \$/MWh despite persistent baseload outages (Mujas 7 & 8) in the range 250 to 500MW. We therefore consider that the Q1 2015 offered flat price of \$48 is excessive.

## Synergy's efficiency

Community supports the Standard Product objective of incentivising Synergy to become more efficient. However, we consider that the emphasis on pricing method is misplaced; rather, the emphasis needs to be on Synergy's exposure to the consequences of its own maintenance and re-commissioning, plus its integration with the maintenance of other market participants. Synergy should not be permitted to mitigate that exposure through Force Majeure provisions that effectively convert its obligation to supply into an option to supply informed by its confidential knowledge of circumstances.

## The Force Majeure Provisions

The Force Majeure provisions are contained in Synergy's Bilateral Trade Agreement for Electricity (Standard Products). The definition of Force Majeure Event includes, amongst other things, breakdown (part (e) and 'curtailment' or 'interruption' (part (g)). Clause 10.1 (a) then places an emphasis on the affected party being 'hindered, prevented or delayed from carrying out, or affected in the performance of ...' its obligations.

Clause 10.1 (c) provides (with underlining added):

(c) Subject to clause 10.1(d), for the purposes of this clause 10, the Seller is deemed to be hindered, prevented or delayed from carrying out, or affected in the performance of, as the case may be, its obligations under this Agreement (including its obligations to make Bilateral Submissions in accordance with this Agreement) if either of the following occur:

- (1) the electricity that can be generated or supplied by the Seller's Facilities is reduced by at least 20% in aggregate as a result of the occurrence of a Force Majeure Event; or
- (2) if Synergy is the Seller, the generation or supply of electricity from a generating unit of a Specified Plant ceases or is completely curtailed or completely interrupted as a result of the occurrence of a Force Majeure Event.

It should be noted that the meaning of the provisions is obscured by the circular use of the concepts of 'curtailment' and 'interruption' in both the definition of the Force Majeure Event part (g) and clause 10.1 (c) (2).

Together with the definitions specified in the Agreement, we interpret condition (1) to correspond to at least 20% of the group of units comprising Synergy's Generating Fleet plus 3rd party units totalling a further 940MW – a total of 3,680MW - which comprises around 70% of the market's generating capacity, and sets the threshold at around 735MW.

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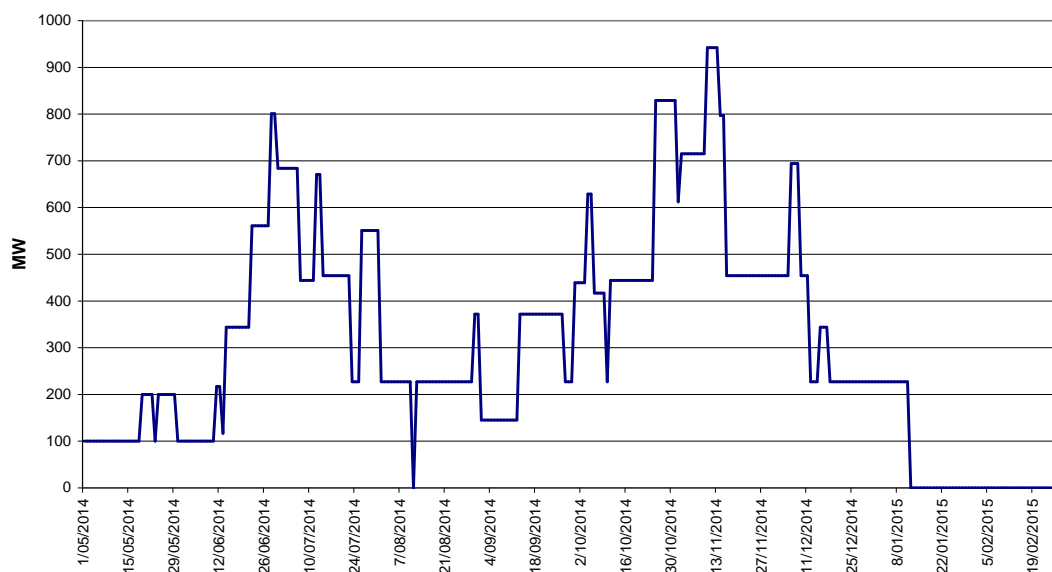
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We interpret condition (2) to refer to a single unit of a group of 11 units totalling certified capacity of 2,300MW.

The figure below shows the quantity of baseload outages (Planned plus Forced) over winter 2014 and demonstrates the likelihood of triggering the Force Majeure protection.

A screenshot of the IMO outage tool for July is also shown, where this registers all outages and flags (in red) Forced Outages. This identifies that 684MW of plant on Synergy's "Specified Plant" list was simultaneously on Planned Outage.

**Baseload Outages 2014**



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We further note that clauses 10.1 (c) and (d) obscure the Force Majeure provisions by blurring the practicality of physically delivering energy (whether self generated or bought from the WEM) with the administrative act of lodging the necessary Bilateral Submission to notify the IMO that an energy transfer has been made.

(d) Nothing in clause 10.1(c) relieves the Seller from liability for making Bilateral Submissions in accordance with this Agreement in respect of a Trading Day, unless the Seller has notified the Buyer of the occurrence of the relevant Force Majeure Event prior to 6.00am on the Scheduling Day for that Trading Day.

The two concepts are very different; 'hindrance' in making a Bilateral Submission has to do with an IT problem a day ahead of the transaction (which is euphemistically hinted at in clause (d)) and nothing to do with operation of a generating plant.

On this basis, we suggest that the existing Force Majeure provisions are dysfunctional, but both the Standard Product Scheme and Synergy's efficiency and can be enhanced by:

- a Restricting the Force Majeure protections and specifically defining them in terms of Planned and Forced Outages of both Synergy itself and those of other Market Participants;
- b Making Synergy responsible and accountable for its own Forced and Planned Outages. For example, the IMO has published a Planned Outage of Muja 6 (190MW) from 8 May to 27 July 2015 (80 days). This ought not to be permitted to trigger supply default under the guise of Force Majeure. Similarly, Muja 8 (225MW) will be conducting commissioning tests over a total of 21 days throughout December 2014 and January 2015 and appears to have tripped and activated spinning reserve.
- c Requiring Synergy to manage its maintenance around the plans of other market participants and bearing the risk of not doing so or being 'unlucky' (being risk management).

## Force majeure provisions are a Synergy put-option

Further to our comments above, we consider that the Force Majeure provisions are effectively a free put option, whereby Synergy can use its inside knowledge of the operating situation to form a view on the likely price during a contingency and then choose whether to claim 'hindrance in making its Bilateral Submission' according to its expected net financial position.

## Synergy's maintenance strategy causes price volatility

It is a matter of record that the timing of Synergy's maintenance of its baseload plant causes price volatility. We quote from the ERA's 2012 Wholesale Electricity Market Report (underlining added):

"While it is expected that generation facilities will not be available during plant maintenance, the observed high level of planned outages of some Verve Energy generating plant is a concern. For example, in the 2010/11 Capacity Year, a number of Verve Energy's plants had planned outage rates of about 50 per cent. Verve Energy's planned outage rates improved in the following year, but still remained high, with some units (for example, Verve Energy's Muja G6 facility, which has a certified capacity of 186.5 MW8) having a planned outage rate as high as 40 per cent.

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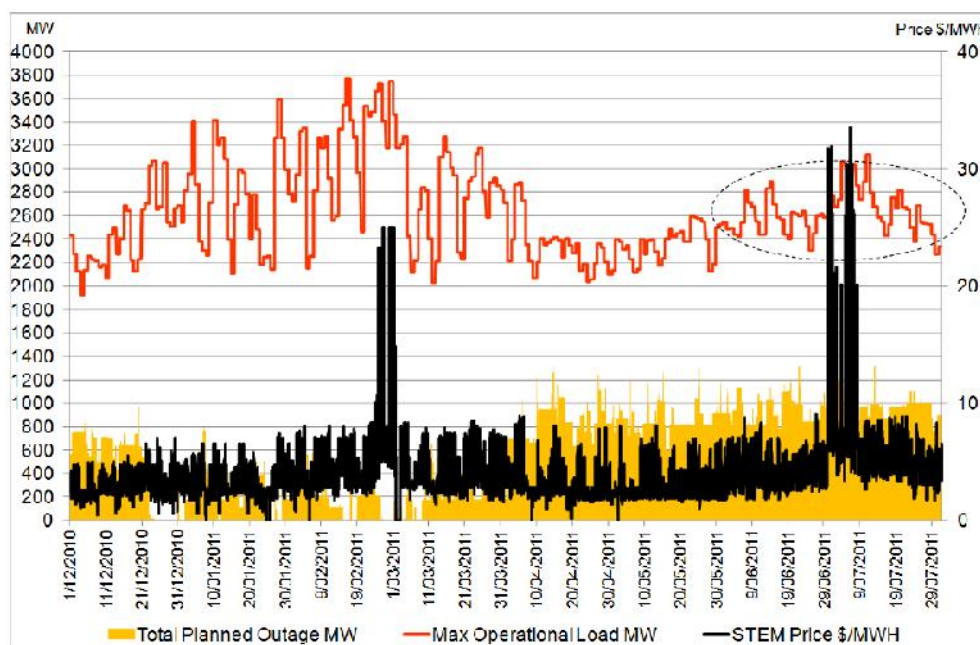
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The Authority notes that the observed unavailability rates in the WEM are significantly higher than the rates for similar plant in other electricity markets and is concerned that generating facilities that are unavailable for half the year are able to receive full capacity payments.

The Authority has also noted a high level of planned outages during periods of tight supply in 2011. As a result, the Authority engaged a consultant to study the relationship between generators' planned outages and high prices in the STEM. This specifically related to price spike periods where the STEM price exceeded \$100/MWh during times when levels of planned outages were high.

The following charts illustrate STEM prices (\$/MWh), operational load (MW) and the volume of planned outages (MW), over the periods 1 December 2010 to 29 July 2011, and 1 December 2011 to 28 July 2012, respectively. The charts show that price spikes occur through the winter period, when demand is generally lower than what occurs in the summer period, and comparatively lower prices are expected. Of note is the coincidence of large volumes of planned outage and high STEM prices, particularly between 27 June 2011 and 9 July 2011. Similarly, high STEM prices are observed to coincide with large volumes of planned outages in early July 2012.

**Figure A4 STEM Price, Operational Load and Planned Outage (1/12/2010 to 31/7/2011)**



The facilities on planned outage included a number of base-load generators, i.e. major, low cost coal units, as well as a number of mid-merit gas units, which would typically result in lower clearing prices when dispatched. The Authority considers that the primary driver for the observed price spikes was likely to be the unavailability of a high amount of base-load capacity. Simulations of market operations showed that the price spikes observed in 2011 would have been significantly reduced if two of the large base-load units were returned to service, whilst the return of three large base-load units would have completely eradicated the spikes.

The Authority considers that incentives to maximise plant availability need to be reviewed. The Authority notes that the IMO has commenced a review of current generator availability and the incentives to improve performance. The Authority supports this undertaking.

Despite the apparent weakness in the Market Rules that is currently under the review of the IMO, the Authority recognises that the issue of plant unavailability appears to be a matter associated with Verve Energy specifically.

We note that the IMO did subsequently approve a rule change that would have alleviated the situation but that its implementation was vetoed by the Minister for Energy. Consequently, the problem remains in place and dominated prices over the recent winter.

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## Synergy's commercial advantage – the Foundation Portfolio

An efficient and sustainable company needs a competitive advantage and insofar as the objective of Synergy's Wholesale Business Unit is competitive neutrality, the source of the corporate competitive advantage is obscured. From this perspective, the Wholesale Business Unit is rendered an anomalous adjunct to the WEM and it would probably be more effective and efficient to locate its function in the Wholesale Market Rules rather than in Synergy.

That said, we consider that Synergy does have a competitive advantage and that it resides in the provisions for supplying the Foundation Customers. As a result of the re-merger, the former Replacement Vesting Contract between Synergy-Retailer and Verve has been replaced in such manner that the Foundation Customers (being Synergy's core business) enjoy Synergy's average generation price while the 'non-discriminatory' terms are quarantined to apply to the incremental cost beyond the quantities reserved for the Foundation customers.

The commercial choice faced by private offtakers is, therefore, whether to pay Synergy's incremental cost for a fixed quantity or, via the Wholesale Electricity Market, pay the Short Run Marginal Cost of the system marginal unit (inclusive of Synergy's plant). While the WEM option is an unhedged spot price, comparison of the WEM prices with Synergy's Standard Product allows identification of the premium being paid for the benefit of the Synergy (Force Majeure constrained) hedge product.

## The benefits to Synergy's Retail Business Unit

Community considers that the present review should focus on outcomes rather than the stylistic implementation of the administrative cliché's of non-discrimination and ring fencing. One hidden outcome of the Standard Product Scheme arises from the symmetric treatment of the RBU and the private sector; in respect of non- Foundation Customers, the RBU is choosing to take supply from the WEM rather than from the Wholesale Business Unit. While this is ostensibly equivalent to the model used by private retailers, an important difference arises in that the RBU is backstopped by the broader corporation in general and the TAP Operating Subsidy in particular. The market is therefore seeing Synergy aggressively compete to retain customers while being insulated from the consequences of the energy price volatility that the private sector has to price into its offerings. This creates a perverse incentive for Synergy to maintain dysfunctional maintenance practices that have a material impact on energy prices.

## The Settlement Price

We note that the regulations are unclear about the nature of the variance settlement of 'overs' and unders' arising from the Nominations for Foundation Load and the Additional Load. We note that Synergy has the ability to arbitrarily set an undisclosed "Settlement Price".

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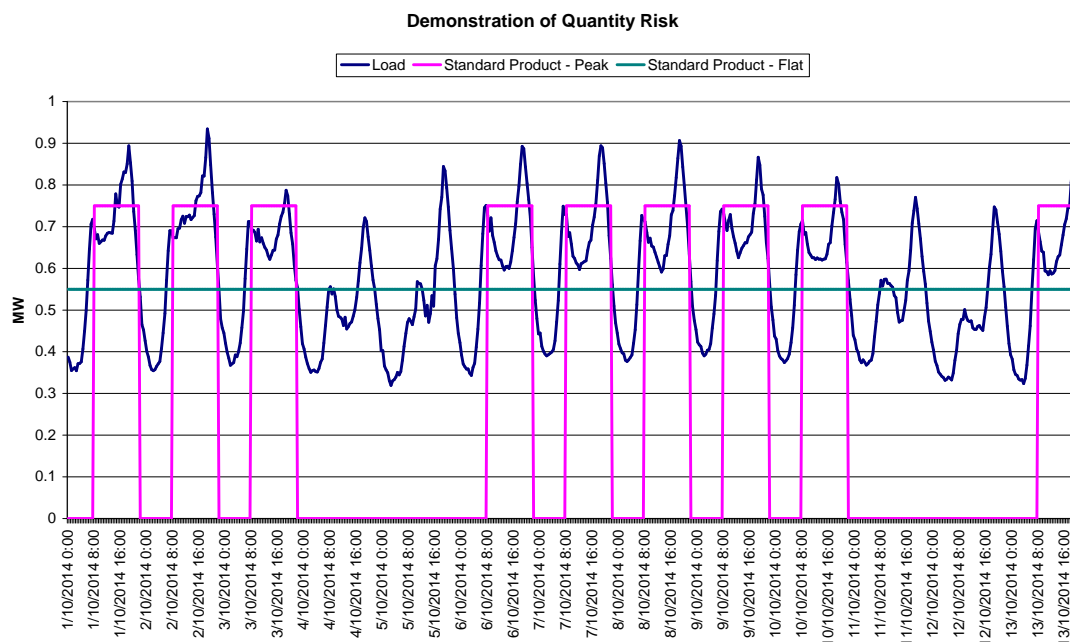
## Confidentiality

The ring fencing arrangements are intended to quarantine confidential information. From the users' perspective, the best protection is to not be compelled to suffer the invasion of privacy where it is not necessary.

In particular, where a participant prepays for an offtake, as is the case for many private retailers of unproven credit standing, we consider that Synergy should have no right to demand information beyond that required by the IMO in the equivalent circumstances. Certainly, it should not have the right to demand a credit reference.

## Quantity Risk

The following figure demonstrates the importance of quantity risk, in which the system load has been scaled and is shown relative to a fixed peak quantity and a fixed flat quantity; the offtaker must choose between buying an excess and spilling the surplus at the uncertain WEM price, versus buying a shortfall and topping up at the WEM price.



## Suggestion – events based products

We suggest that Synergy's efficiency would be incentivised if it was compelled to offer sell- products throughout the duration of planned and forced outages, with start and finish dates adjusting to suit. For example, a buyer could take a 'one baseload unit' or two baseload unit product automatically from the outage commencement. Similarly for a forced outage.



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## Necessary refinements for the Standard Product Scheme to be effective

While Community accepts in good faith that 10MW of sell product was sold in respect of Q4 2014 and that the pricing & Force Majeure arrangements may have operated reasonably, we consider the Scheme to be dysfunctional because the ancillary terms are either unreasonable or do not correspond to users' needs. We suggest that the following features are necessary for the Scheme to be credible:

- a Reasonable Force Majeure protections, as described above, including express reference to Forced Outages and Planned Outages;
- b Provision of an Off Peak product (the pricing of which is already implicit, though the product is not available); for example, the implied Off Peak Price for Q4 2014 is 31.6 \$/MWh compared with an actual WEM price of 34.5 \$/MWh;
- c Provision of products to match the Market Rules definitions of Peak and Off Peak (thereby creating 'overnight' and 'daytime' products);
- d Supply periods of 1 month with flexible (mid month) commencement dates (rather than the current calendar quarter);
- e Requiring that where an offtake is prepaid in the form of cleared cash on a monthly basis, Synergy will not require provision of Financial Statements or 3rd party credit assessments. The administration should be no more onerous than is required by the IMO; specifically, where a market participant prepays the IMO there is no requirement for an administrative burden or financial intrusion.

We further suggest that the Scheme could be made attractive by including the following features:

- f Retaining the obligation placed on Synergy to offer symmetric Buy & Sell pairs only where it makes sense with respect to the likelihood of being used.
- g The provision of event-cover, such as a sell product commensurate with the timing of the outages of baseload units.
- h The provision of sell-only time-blocks targeted at market conditions; for example 5-hour blocks commencing at, say, 05:00 and 16:00 to cover the operation of peaking stations;
- i The provision of basic risk management products such as options and caps;

## Stakeholders are invited to comment on:

**Whether the criteria the ERA proposes to use in its assessment of the effectiveness of the operation of the Regime are appropriate.**

Community broadly supports the ERA's proposed criteria and approach with respect to the stylistic aspects of the Scheme. We note the absence of formal criteria in the regulations and that the ERA has to infer the intent of the regulations from a parliamentary speech and public presentations by the Merger Implementation Team. We consider that the requirement placed on the ERA to excavate and interpret secondary sources undermines the integrity of the regulations and demonstrates that the intent of the initiative is 'informal' rather than transparent.

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Fundamentally, the utility of the Standard Product scheme is demonstrated by the degree of its uptake and by comparison with the actual WEM alternative, as we have set out in this submission. We suggest that the emphasis of the review should be on pricing outcomes in comparison with the actual WEM prices.

**What prevailing circumstances or other matters the ERA should take into account when assessing the effectiveness of the operation of the Regime, and why.**

Community considers that the emphasis on ‘mitigating the concerns’ of industry participants more properly applies to the governance structure of the electricity supply industry rather than being confined to the functioning of the EGRC Regulations. We consider that the central issue is the impact of sovereign risk on the investment climate and that in this case the symptom of sovereign risk is the unilateral re-merger of the former Synergy and Verve without consultation and in the face of opposition from diverse stakeholders. It seems to us that the EGRC Regulations are in practice merely public relations camouflage to mask sovereign risk rather than a genuine market mechanism.

Community considers that the EGRC regulations seek to reframe the re-merger of Synergy-Retail and Verve Energy as an efficiency enhancement of the previous market structure rather than protection of the State Trading Enterprises, and attempts to justify it in terms of the administrative clichés of ring fencing and non-discrimination. In reality, the success or failure of the initiative depends on the extent to which Risk Management products are effectively provided and taken up. From this perspective, this initiative is reminiscent of Sir Humphrey’s most efficient hospital in Britain; despite the staff being overworked and the hospital being fully functional, there were nonetheless no patients.

**Stakeholders are invited to comment on how effective the operation of the Regime is in mitigating any concerns that stakeholders may have, in terms of:**

- **the requirements in relation to segregation and ring-fencing; and**
- **how the requirements have been implemented by Synergy.**

Community considers that the re-merger represents interposition of a single board of directors between ‘the Owner’ (represented by the Minister for Energy) and the heads of the retail and generation businesses. We note that four reportable business units (Generation, Wholesale, Retail and Corporate Services) have replaced the former Generation and Retail businesses and that these four business units map onto eight business units in the new Synergy structure. We understand that corporate strategy is considered a ‘shared service’ that transcends the ring fencing. We encourage the ERA to investigate whether this structure achieves the “efficiency” objective and how strategic development can meaningfully be conducted within it.

**Additionally, stakeholders are invited to comment, to the extent that stakeholders have any knowledge or evidence, on how effective the operation of the Regime has been in:**

- **ensuring Synergy does not unduly preference its own retail and generation arms over third party retailers and generators; and**



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- **providing the private sector with access to electricity on non-discriminatory terms.**

We consider that the original Replacement Vesting Contract between the former Synergy and Verve has been replaced by the Foundation Customer arrangements in such manner that the Foundation Customers (being Synergy's core business) enjoy Synergy's average generation price while the 'non-discriminatory' terms are quarantined to the incremental cost beyond the quantities reserved for the Foundation customers. The commercial choice faced by private offtakers is whether to pay Synergy's incremental cost for a fixed quantity or take the precise quantity from the WEM at the short run margin cost of the system marginal unit. While the WEM option is an unhedged spot price, comparison of the WEM prices with Synergy's Standard Product allows identification of the premium being paid for the benefit of constrained-hedging via the Synergy alternative. [The Synergy-hedged product is constrained because it is subject to the Force Majeure provisions of Synergy's Bilateral Trade Agreement for Electricity (Standard Products)]. We illustrate the issue by way of a real-life example:

- 1 Energy prices are historically volatile over winter.
- 2 Synergy plans an outage of Muja 6 (190MW) from 8 May to 27 July 2015 (80 days).
- 3 Clarification needed: does this remove Synergy's obligation to supply during this period through operation of Force Majeure?
- 4 If an offtaker wishes to hedge the price during this period via a standard product, it must buy for 6 months - 1 April to 30 June and 1 July to 30 September.
- 5 There is no guarantee that Synergy will conduct the maintenance as currently planned; it is usual practice for generator maintenance to be rescheduled.

**The ERA is also interested in any practical experience stakeholders may have of these requirements and Synergy's implementation of them, including in relation to:  
the complexity and cost of implementing the requirements; and  
• whether the requirements have increased pressure on Synergy to be efficient.**

Community considers that the Standard Product Scheme has no bearing on Synergy's efficiency and that the Force Majeure protections need to be minimised for efficiency benefits to be achieved. As described above, at a minimum, Synergy needs to be exposed to the consequences of its own maintenance (planned and forced) and re-commissioning. Broader exposure to the maintenance of the market as a whole would promote further efficiency.

**Stakeholders may wish to consider the following points when making a submission:**

- **Whether the level of segregation and ring-fencing required by the EGRC Regulations is adequate to ensure the Generation or Retail Business Units do not have an unfair advantage in comparison to their respective competitors.**

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- **How effective the controls around access to third party information are in ensuring the Generation or Retail Business Units do not have an unfair advantage in comparison to their respective competitors.**
- **Whether there is sufficient information publicly available to enable stakeholders to fully understand how activities have been segregated.**

Community considers the emphasis on pressuring Synergy to be efficient, ring fenced and publish information to be administrative clichés that can be successfully achieved while the substance of the Scheme remains dysfunctional; Synergy's commercial advantage is hidden in the provisions for the Foundation Customers. The key determinant of the success of the products is the degree of their uptake. While the provision of information is important to promote efficiency, the emphasis is misplaced; scrutiny of Synergy's operation and maintenance of its generation fleet is far more important than oversight of its administration.

**Stakeholders are invited to comment on how effective the operation of the Regime is in mitigating any concerns that stakeholders may have, in terms of:**

- **the requirements in relation to the wholesale supply and acquisition of electricity; and**
- **how the requirements have been implemented by Synergy.**

**Additionally, stakeholders are invited to comment, to the extent that stakeholders have any knowledge or evidence, on how effective the operation of the Regime has been in:**

- **ensuring Synergy does not unduly preference its own retail and generation arms over third party retailers and generators; and**
- **providing the private sector with access to electricity on non-discriminatory terms.**

Community considers that the present review should focus on outcomes rather than implementation of the administrative clichés of non-discrimination and ring fencing. One hidden outcome of the Standard Product Scheme arises from the symmetric treatment of the RBU and the private sector; in respect of non- Foundation Customers, the RBU is choosing to take supply from the WEM rather than from the Wholesale Business Unit. While this is ostensibly equivalent to the choice made by private retailers, an important difference arises in that the RBU is backstopped by the broader corporation in general and the TAP Operating Subsidy in particular. The market is therefore seeing Synergy aggressively compete to retain customers while being insulated from the consequences of the energy price volatility that the private sector has to price into its offerings. This creates a perverse incentive for Synergy to maintain dysfunctional maintenance practices that have a material impact on energy prices.

As described above, we are concerned that the discrimination lurks in the Force Majeure provisions, the Foundation Customer provisions and the Credit Policy.

**The ERA is also interested in any practical experience Stakeholders may have of these requirements and Synergy's implementation of them, including in relation to:**

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- the complexity and cost of implementing the requirements; and
- whether the requirements have increased pressure on Synergy to be efficient.

Stakeholders may wish to consider the following points when making their submission:

**Does the Wholesale Electricity Supply Policy ensure a fair and reasonable process for dealing with wholesale customers? If not, why not?**

**Any evidence that the terms offered in the Wholesale Electricity Supply Policy and/or Wholesale Energy Credit Policy are any less favourable than those offered to Synergy's Retail Business Unit.**

As described above, we consider that the Foundation Customer provisions are intrinsically discriminatory and especially so in respect of the Force Majeure provisions.

We consider that while Synergy ought to properly protect itself from credit risk, there is no such risk where the participant prepays in cash and consequently Synergy should not be permitted to intrude on participants' privacy or create an administrative burden.

**Whether the Regulations include adequate controls to ensure that Synergy meets its obligations. Stakeholders are invited to comment on how effective the operation of the compliance requirements of the EGRC Regulations have been, or are likely to be, in mitigating any concerns they may have.**

**Additionally, stakeholders are invited to comment, to the extent that stakeholders have any knowledge or evidence, on how effective the operation of the Regime has been in:**

- ensuring Synergy does not unduly preference its own retail and generation arms over third party retailers and generators; and
- providing the private sector with access to electricity on non-discriminatory terms.

We would emphasise that through the WEM, the private sector already has ample access to electricity on non-discriminatory terms; it is risk management products that are needed from Synergy and the current Scheme does not facilitate them.

We re-iterate our views on the provisions for the Foundation Customers constituting an advantage to Synergy.

**The ERA is also interested in any practical experience stakeholders may have of these requirements and Synergy's implementation of them, including in relation to:**

- the complexity and cost of implementing the requirements; and

We consider that simple and quick credit approvals should apply where a participant prepays in cleared cash.

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- **whether the requirements have increased pressure on Synergy to be efficient.**

We consider that the requirements place no pressure on Synergy to be efficient. We reiterate our comments on the need to properly integrate the Force Majeure provisions with Synergy's internal maintenance strategy in particular and the market is general.

**Stakeholders may wish to consider the following points when making a submission:**

**Whether the compliance requirements are sufficient to ensure Synergy is held accountable to its obligations under the EGRC Regulations.**

- **Whether the audit process could be better aligned and integrated with the review of the effectiveness of the operation of the Regime.**
- **Whether the penalty provisions are suitable for discouraging Synergy from engaging in discriminatory behaviour.**

We re-iterate our view that the emphasis on ring fencing and non-discrimination in constrained circumstances is an insubstantial clichés. We consider the civil penalties to be just a further cliché. There are effectively no penalty provisions to ensure compliance; it makes no difference to the market or to Synergy whether money is paid to the Treasury in the guise of being a civil penalty, a dividend, or a reduction in the TAP subsidy. We are confident that the regulations would be complied with if the continued employment of nominated individuals was made conditional upon it. We are, however, less confident that this would add any substance to the Scheme in terms of delivered value.

**Stakeholders may wish to consider the following points when making a submission:**

- **Whether the Guidelines include sufficient requirements to provide transparency around the transfer pricing process.**

We reiterate that the private sector needs properly valued risk management products and that the proof of efficacy is their uptake by the market. The internal administration of delivery of such a positive outcome is immaterial. Equally, and more importantly, Synergy should not be permitted to oversee an administratively perfect Scheme that nobody uses.

Transparency arises from comparison of the Standard Products with the WEM price history, whereby the inherent premium can be calculated and compared with the risk mitigated in terms of Planned and Forced Outages. The mechanism for arriving at those prices is of relatively minor consequence. We consider the product pricing to be excessive and that this could be mitigated by compelling Synergy to offer the Off Peak product that is already inherent in its other product.

**The ERA is also interested in any practical experience stakeholders may have of these requirements and Synergy's implementation of them, including in relation to:**

- **the complexity and cost of implementing the requirements; and**

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- whether the requirements have increased pressure on Synergy to be efficient.

Stakeholders may wish to consider the following points when making a submission:

- How effective the Standard Products are in imposing discipline on Synergy's wholesale pricing?
- To what extent the Standard Products have provided a competitive benchmark price to the wholesale supply of electricity on a non-discriminatory basis?
- To what extent the Standard Products have provided an alternative to customised products?

We reiterate our responses above. The products:

- do not pressure Synergy into being efficient because it is not exposed to the consequences of its maintenance performance;
- don't impose discipline on Synergy's wholesale pricing because there are insufficient sellers and Synergy does not offer the implied Off Peak product;
- don't represent equality with Synergy's RBU because of the Foundation Customer provisions, and the non-discriminatory symmetry enables the RBU to take the WEM alternative without regard to the price risk in the knowledge that it will be bailed out if necessary;
- are not a cost-effective alternative to a WEM offtake with the attendant price volatility;
- while the products do provide a forward price curve, it is undisciplined and not credible; certainly, it is not as effective as forecasting the WEM price.

- **Whether the Standard Products have reduced barriers to entry for new entrant retailers and allowed Market Participants to rebalance their portfolios.**
- **Whether the type of products and minimum volumes specified in the Standard Products Arrangements are appropriate and useful.**

The products have not reduced barriers to entry because of the profile (quantity) risk via the peak and flat options, the long minimum period (a calendar quarter), Synergy's Force Majeure protections and intrusive and unreasonable credit policy in respect of cash prepayments.

The minimum quantity is reasonable.

- **The level of the spread between Buy and Sell and whether it has been effective in underpinning price efficiency.**

The Buy – Sell spread is not relevant because there are no credible sellers to Synergy. Price efficiency is best assessed by comparison with the WEM prices, which facilitates the calculation of the premium inherent in the product pricing. As described above, we consider that Synergy should be compelled to offer the Off Peak product that is already

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inherent (but not offered) in the current products. We further consider that there is evidence that the price trend for this is unreasonably high.

## • Are fair and reasonable procedures employed in the operation of the Standard Product Regime? If not, which procedures require amendment and why?

As stated, above we consider the products to be dysfunctional because of the quantity & profile risk, minimum term, inflexible start dates, intrusive credit policy and unreasonably broad Force Majeure terms.

## What improvements, if any, could be made to the Standard Product Regime?

- i Provision of an Off Peak product (the pricing of which is already implicit, though the product is not available);
- ii Provision of products to match the Market Rules definitions of Peak and Off Peak (effectively 'daytime' and 'overnight' pricing);
- iii Supply periods of 1 month with flexible commencement dates (rather than the current calendar quarter);
- iv Clarification and more detailed consideration of the impact of Forced Outages and Planned Outages
- v Restricting the Force Majeure protections and specifically defining them in terms of Planned and Forced Outages;
- vi Making Synergy responsible and accountable for its own Forced and Planned Outages. For example, the IMO has published a Planned Outage of Muja 6 (190MW) from 8 May to 27 July 2015 (80 days). This ought not be permitted to trigger supply default under the guise of Force Majeure. Similarly, Muja 8 (225MW) will be conducting commissioning tests over a total of 21 days throughout December and January; this has already increased energy prices through the scheduling of extra spinning reserve;
- vii Requiring Synergy to manage its maintenance around the plans of other market participants and bearing the risk of not doing so or being 'unlucky' (risk management).
- viii Requiring that where an offtake is prepaid in the form of cleared cash on a monthly basis, Synergy will not require provision of Financial Statements or 3<sup>rd</sup> party credit assessments. The administration should be no more onerous than is required by the IMO; specifically, where a market participant prepays the IMO there is no requirement for an administrative burden or financial intrusion.
- ix Removal of the obligation placed on Synergy to offer symmetric Buy & Sell pairs on every offering. While we acknowledge that this requirement imposes a prima facie discipline on Synergy, this is only effective if credible sellers to Synergy actually exist, which we perceive not to. From this perspective, the net effect is to constrain Synergy in the products that it can reasonably sell without creating a theoretical risk exposure.
- x The provision of event-cover, such as a sell product commensurate with the timing of the outages of baseload units.

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- xi The provision of sell-only time-blocks targeted at market conditions; for example 5-hour blocks commencing at, say. 05:00 and 16:00 to cover the operation of peaking stations;
- xii The provision of basic risk management products such as options and caps;

## Contact

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