Community Electricity

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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

Submission

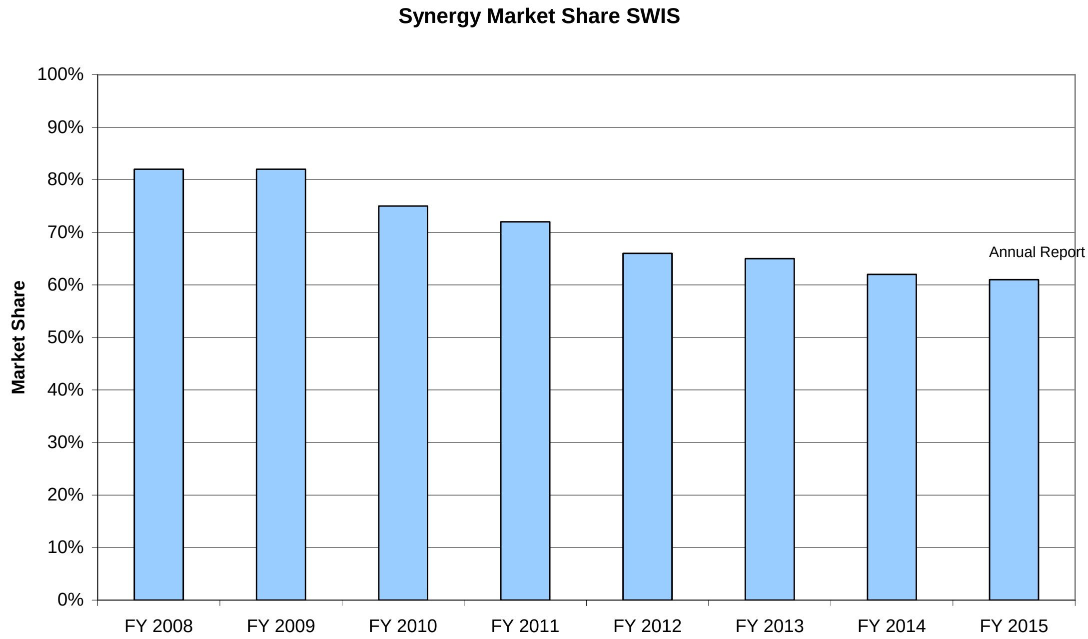
1. Community Electricity made a substantial submission to the 2014 review, which is listed in Appendix 1. That submission continues to stand; our submission to the current round comprises re-submission of that earlier submission plus the following updates to it.

2. We offer to provide further supporting information under confidentiality and request a private meeting to that effect.

3. We remain of the view that the Standard Product regime is dysfunctional for the reasons stated in the December 2014 submission. In particular we consider the Standard Products to be self-nullified by their Force Majeure provisions. We emphasise that:
   - independent retailers can sufficiently procure energy from the wholesale market at full spot-price risk;
   - the potential merit of the Standard products is in hedging the price risk;
   - Synergy controls ¾ of the generation supply;
   - price risk is caused primarily by Synergy outages;
   - the Standard Products contain Force Majeure provisions that enable Synergy to suspend supply during sufficient and vaguely defined outages

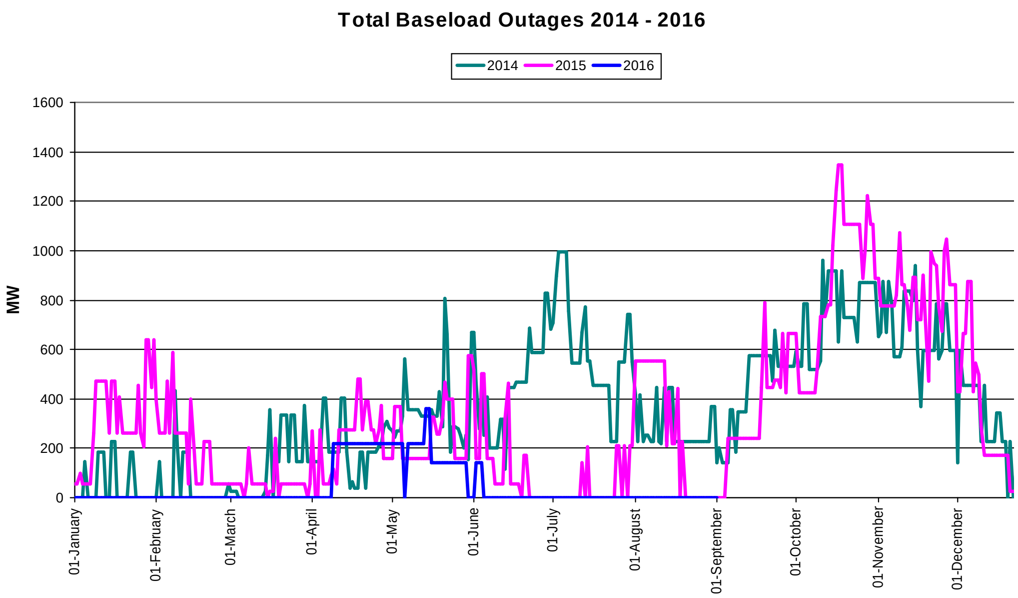
4. We consider the uncertainty over the objectives of the Scheme to be a prime cause for the general dysfunction of the Standard Products spawned by the scheme; both Synergy and the ERA are reduced to excavating the parliamentary speeches for clues as to the intent of the regulations, and then disagree over whether the review should apply to the appropriateness of the regulations themselves or to the actual product outcomes that arise from them. We further note the Minister for Energy's dismissal of the ERA's first review, which we include as Appendix 2, and highlight as part of the dysfunction.

5. We note the Minister's claim that Synergy has "dramatically lost market share" after the merger of Synergy and Verve. We include below the Synergy market share data published by the IMO.



Source: IMO submission to the Electricity Market Review Discussion Paper.

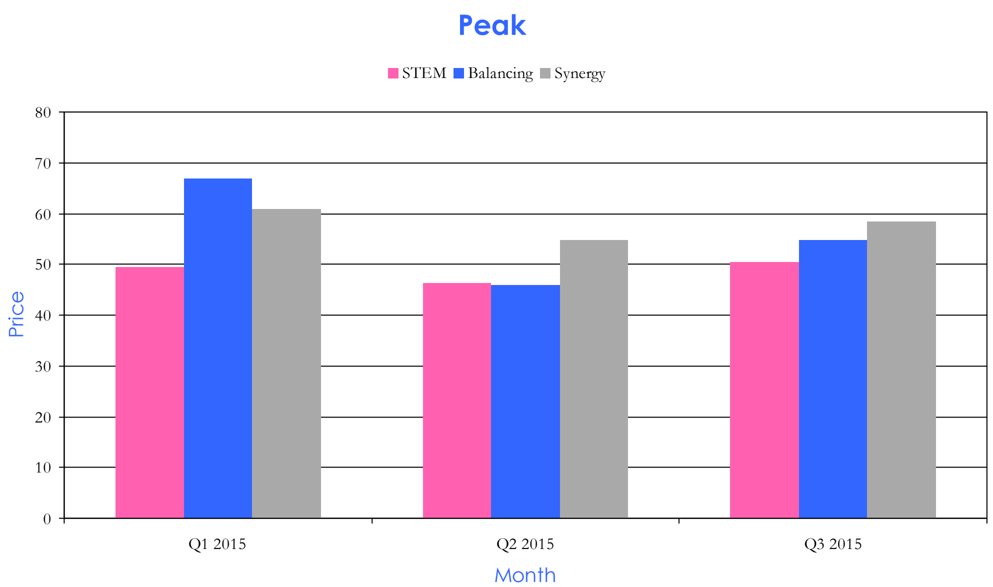
6. We update our assessment of the relevant baseload outages as shown below. Of particular interest, we welcome the rescheduling of the winter outages that we highlighted in our 2014 submission. In the event, outages were extremely light over winter. There is now evidence that outages have been systematically moved to the spring, which is where we consider they should take place due to the lower load and preparation for summer.

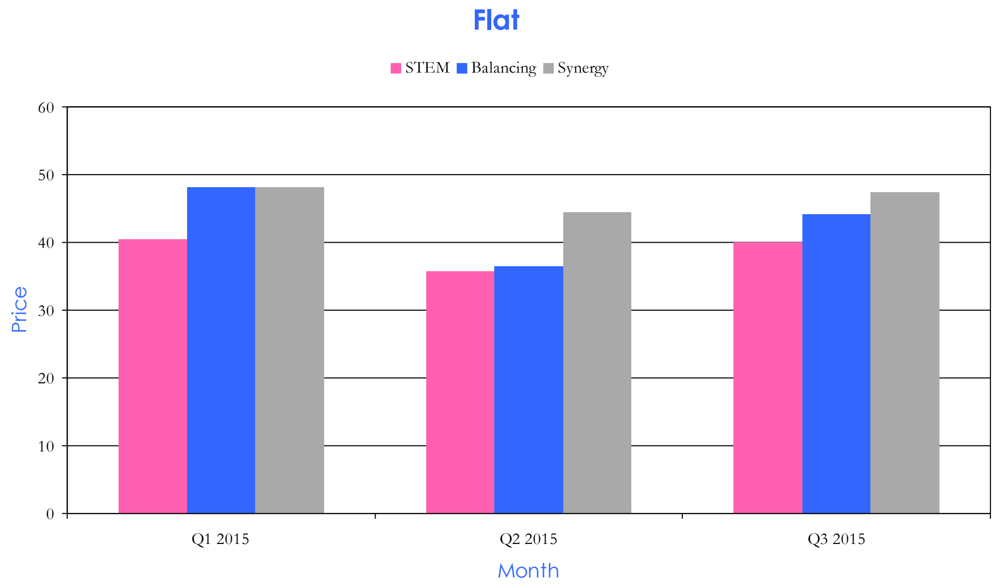


Note - the graphs concentrate on outages of the energy producing plant (>20MW for >1 day) and do not include peakers and renewable plant. The 2016 outages are planned.

7. We reiterate our concerns about the Force Majeure provisions of the Standard Products and call attention to the excessive outages during summer 2015, many of which incurred substantial penalties. A screenshot from the IMO website is shown below, which lists over 1,000MW of Synergy Forced Outages (shown in orange) on the day and extensive Forced Outages throughout the month.

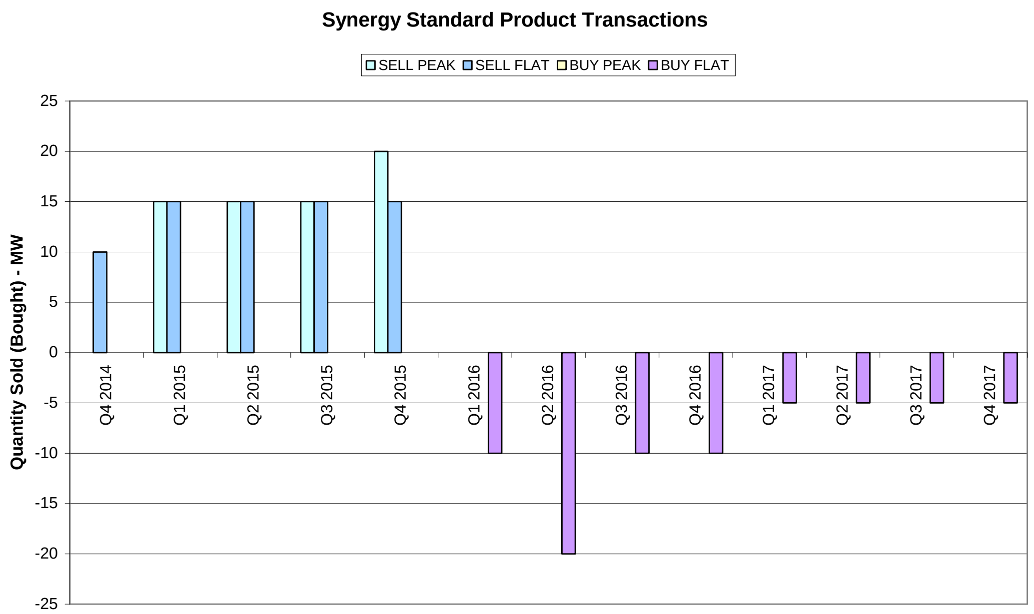
8. We update our assessment of the quarterly Standard Products versus the corresponding STEM and Balancing alternatives as follows.



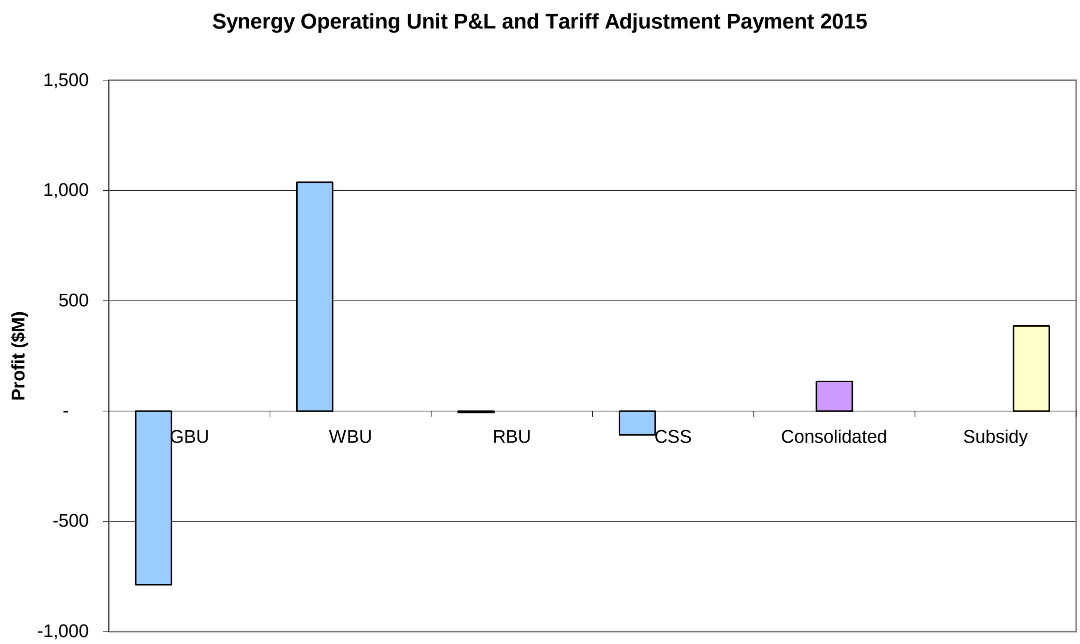


We note that notwithstanding the unprecedented level of Synergy outages, in Q1 2015 the STEM offered the optimal pricing outcome, being around 20% cheaper that the corresponding Standard Products assuming that Synergy didn't invoke its FM rights.

9. We note that 14 transactions have taken place under the scheme, each of 5MW quantity. These are summarised in the following chart, where it is seen that there is a temporal asymmetry – all the Synergy-Buys are post 2015 and all the Synergy-Sells are pre-2016. We consider that the seller to Synergy is a baseload generator, for which the Synergy-Buy prices are attractive, and especially so when the forward prices contained provision for futuristic contingencies; the prices for the flat 2016 Synergy-Buy transactions are only 7% lower than the final Synergy-Sell compared with the original 25%.



10. We call attention to Synergy's 2015 Annual Report, from which we interpret the following chart showing the relative performances of Synergy's various business units. In particular, we note that the transfer pricing was arranged so that the Wholesale Business Unit made a profit of $1,000 million while the Generation Business "lost" nearly $800 million (which we estimate to represent $95/MWh-sent out). The Retail Business Unit approximately broke even. The chart also shows that Synergy received an operating subsidy of $386 million, of which $135 million was rebadged as profit. We note that elimination of the subsidy is a pre-condition for the introduction of Full Retail Contestability under the Electricity Market Review.

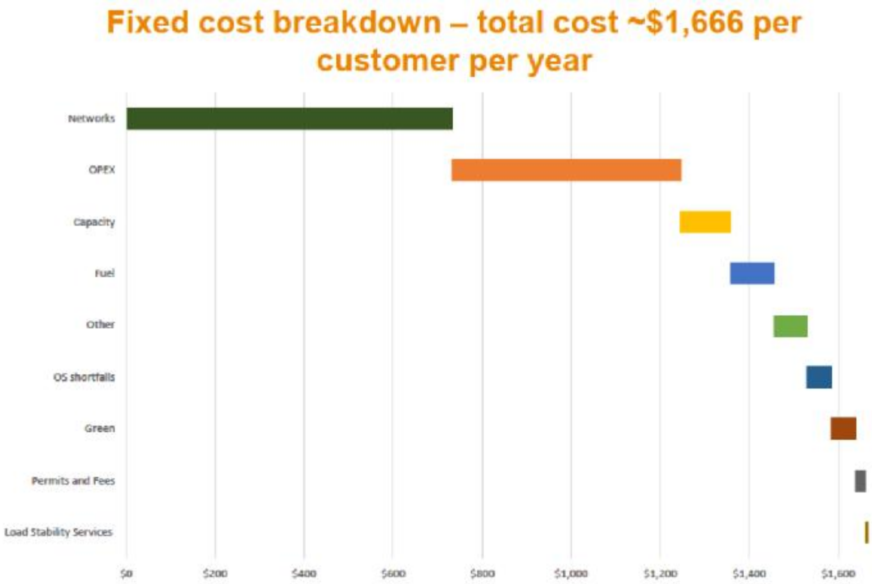


11. Noting that Synergy's 2015 Annual Report is the first full year after the merger, we encourage the ERA to highlight any evidence of the supposed benefits of the merger.

12. We call attention to the statement of the average cost of supply to residential customers in a recent presentation by Synergy to the CEDA. We note Synergy's statement that an A1 customer possessing no PV and no battery storage contributes revenue of $1,714 per year against the cost of supply of $2,042 (being a loss of 16% or $328), of which $1,666 is fixed. This presentation also lists the cost structure as follows, where we call attention to the second largest item – "OPEX" - which costs approximately $520 per year, or 31% of the total fixed cost.

    Community Electricity's proprietary Wholesale Electricity Market Cost of Supply Indicator (WEMCOSI) provides an indication of the cost of supplying various classes of standard customer, including the A1 (residential). This model links the cost of supplying each customer class to the specific line items on supplier invoices, being principally network, IMO (energy, capacity, ancillary services &

market fees) and Clean Energy. We then define a Headroom, in which competition takes place, as being the price space between revenue and cost of supply excluding retail operations and financing costs. In matching WEMCOSI to the line items in Synergy's chart we note, as expected, the presence of network, fuel, capacity and Clean Energy. However, we encourage the ERA to scrutinise the OPEX cost and confirm its validity. If this is related to the cost of retail operations, we suggest it is far in excess of the costs that would be incurred by a new entrant retailer. Its relationship to the subsidy is also very important for the prospective FRC.



Source: Synergy presentation to CEDA

13. We further note that, on the face of it, the "fixed" network cost (amongst others) is very close to the full (fixed and variable) network cost, and compares to the much lower published network fixed cost of $209+GST per year. We also call attention to the implied and unexplained variable cost of $328, which we encourage the ERA to explore.

14. We note and confirm press reports that independent retailers have made a submission to the ACCC challenging the legitimacy of Synergy's pricing to some contestable customers. The essence of the challenge is that Synergy prices some contestable customers at the equivalent of the Wholesale Electricity Market price without prudent allowance for energy price volatility. While on the face of it, this is similar to the business model operated by some independent retailers, the challenge arises because:

    - it is Synergy itself that is the primary cause of the energy price volatility (through its outages);
    - Synergy receives a substantial subsidy from Government which it rebadges as consolidated profit and can use to cross-subsidise any losses so incurred;
    - Synergy's Standard Products are set at prices that render uncompetitive any retail offering based on them;

- Synergy's Standard Products contain FM clauses that nullify the products during the very time that they are needed;

Further, Community Electricity has used WEMCOSI to back-calculate the pricing parameters used by Synergy in some of its offers to contestable customers. When we use those same pricing parameters for the residential customer class, we estimate that Synergy would make the same financial return as it does for the relevant contestable customers. Specifically, in respect of residential customers we estimate positive Headroom and no need for a subsidy.

Contact

For further information or comment, please contact:

Dr Steve Gould
steve@communityelectricity.net.au
0408 005 321

21 December 2015

Appendix 1 – Submission to the December 2014 Review of the effectiveness of the EGRC Regulatory Scheme

The original submission is the basis for the current submission and is available at:

https://www.erawa.com.au/cproot/13123/2/20141224%20Public%20Submission%20-%20EGRC%20Regulatory%20Scheme%20-%20Community%20Electricity.pdf

Appendix 2 – Minister's response to the ERA's report of the effectiveness of the EGRC Regulatory Scheme

Extract from *Hansard*
[ASSEMBLY — Thursday, 25 June 2015]
p4892b-4893a
Mr Bill Johnston; Dr Mike Nahan

ELECTRICITY GENERATION AND RETAIL CORPORATION —
ECONOMIC REGULATION AUTHORITY REPORT

549. Mr W.J. JOHNSTON to the Minister for Energy:

I refer to the "2014 Report to the Minister on the Effectiveness of the Electricity Generation and Retail Corporation Regulatory Scheme" of March 2015 by the Economic Regulation Authority.

(1) Does the minister agree with the ERA's comments on page 7 that the conditions necessary for vigorous competition do not exist in the WEM?

(2) Does the minister accept the ERA's comments on page 8 that following the merger in 2014, Synergy has increased its overall dominance in the market?

(3) Does the minister also agree with the ERA's comments on page 9 of the report that the ERA considers that structural separation of Synergy would be the best means to facilitate … competition and private sector investment?

Dr M.D. NAHAN replied:

(1)–(3) I thank the member for the question. Yes, that report was tabled today. The ERA, as part of the changes in regulation following the merger, was required to report annually on a whole range of instruments that were put in place at the time of the changes to limit the monopoly power, or the market power, of the combined entity. This is the first of the reports. The ERA indicated strongly in this report that it did not have the data to make that measurement. It did not have the data to assess whether it was or was not. I might add that the report provides no evidence that there has been an enhancement or a use of monopoly power or market power by Synergy. In fact, it was put to the ERA that Synergy is losing market share in the contestable market. There are two sides. Synergy has a basic monopoly among the small users but competes widely with the private sector and the larger users. It dramatically lost market share after the merger. In fact, its market share is down to slightly over 30 per cent. The question is, if they did not have that day-to-day assessment and if there is no illustration or data supporting the use of market share, why the recommendation? It went out and talked to a range of market participants. I am not surprised that market participants in this market set up by Labor, whose whole business plan is to live off the state, complained. When the Economic Regulation Authority does the next review, it will rely on data rather than on interviews with private players, and if it shows there is a use of the existence of market power and the use of market power, I will be concerned. But right now, the ERA report—it cost $400 000, I might add is not a good report; it did not do what it was supposed to do.

Mr B.S. Wyatt: Because it was embarrassing to you, that is why.

Dr M.D. NAHAN: The ERA's report is an embarrassment on the part of the ERA; yes.