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The Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Dr Tamblyn

REVIEW OF ENERGY MARKET FRAMEWORKS IN LIGHT OF CLIMATE CHANGE POLICIES – 1ST INTERIM REPORT

Synergy welcomes this opportunity to comment on the Australian Energy Market Commission's (AEMC's) 1st Interim Report: Review of Energy Market Frameworks in Light of Climate Change Policies (the Report).

Synergy is Western Australia's (WA's) largest energy retailer, with more than 970,000 industrial, commercial and residential customer accounts and with total revenue of more than $1.5 billion annually. Our interest in the Report manifests itself through the potential for direct impacts of the Carbon Pollution Reduction Scheme (the CPRS) on our gas retailing activities, the broader impacts of both the CPRS and the expanded Renewable Energy Targets (the RET) on our wholesale procurement activities, and through the implications to energy pricing which arise with the pass through of these costs to consumers.

Synergy appreciates the efforts of the AEMC to understand the particular dynamics of the energy industry in WA and to make independent consideration of these matters within the Report. We are keen to further engage on these issues. For further information associated with this submission, please contact Mrs Jenni Conroy (08-6212 1661).

Yours sincerely

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REVIEW OF ENERGY MARKET FRAMEWORKS IN LIGHT OF CLIMATE CHANGE POLICIES – 1ST INTERIM REPORT

B1. CONVERGENCE OF GAS AND ELECTRICITY MARKETS

1. Do you agree that convergence of gas and electricity markets in WA are not a significant issue and therefore should not be progressed further under this review? If not, what are your reasons for reconsidering this position?

Synergy supports the AEMC's view that, at least in the early stages of the CPRS when carbon prices are relatively low, it is unlikely that fuel shifting from coal to gas will occur in WA. This reflects that the price of gas in WA has risen substantially in recent years, reflecting the shift in pricing to an LNG netback approach and the relatively strong international demand being experienced for LNG. Synergy views that this situation will continue until such time as the Short Run Margin Cost (SRMC) for coal generation plants exceeds that for gas generation plants.

While it is unlikely that the CPRS will stimulate increases in demand arising from switching of generator feedstocks, it is likely that the RET will have the effect of increasing the demand for gas fired quick start generators (as a back up plant for intermittent renewable generators such as wind farms) and that this may exacerbate existing limitations within gas markets and pipelines.

Synergy remains very concerned that the existing gas markets in WA are not sufficiently flexible and responsive to handle the increased volumes and highly variable supply requirements of gas-fired generation used to provide peak generation and back up for intermittent renewable generators.

Further, with the Dampier to Bunbury Natural Gas Pipeline (DBNGP) not upgraded unless capacity is fully contracted,[1] there remains a high probability of increased congestion on the gas network, such that variable gas plant may not be able to acquire non-firm transportation capacity to align its fuel contracting with the operating requirements anticipated for the plant within the Wholesale Electricity Market (the WEM) rules. This is exacerbated by the fact that there are very limited gas storage facilities in this State[2].

We note that the WA State Government has recently commenced a review of gas supplies in the State. Synergy will input into this process. It is likely that this review will focus predominantly on gas reliability concerns, which came to light during the Varanus Island crisis, and ignore issues arising from the implementation of Government's climate change policies. It may therefore be beneficial for the AEMC to continue to maintain an interest in these matters.

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[1] A prospective capacity upgrade has been the subject of discussion for some 5 years.
[2] There is some limited storage available within the Mondarra gas storage facility.

B2. GENERATION CAPACITY IN THE SHORT TERM

1. Do you agree that generation capacity in the short term in WA is not a significant issue and therefore should not be progressed further under this Review?

With regard to the development of new generation facilities over the short to medium term, Synergy has previously identified to the AEMC some significant barriers to be addressed by proponents, including:

- Delays in securing network connections associated with the operation of Western Power's management of queuing policies;
- Cost of network connections, particularly for intermittent plant for which Western Power adopts an unconstrained network planning approach, rather than allowing proponents to access network sharing arrangements;
- The need to contract for backup fuel supplies to meet the Market Rule requirement that the facility hold access to fuel supplies sufficient to operate for at least 14 hours each day. For peaking plant, this creates a substantial cost impost to be passed through to end users. This is practically very difficult to deliver against given the current contracting regime for gas transportation where it is difficult to secure non-firm capacity. We note that the IMO is currently reviewing this issue, however, in their current form, the Market Rules create a substantial barrier for new developments; and
- Planning and approvals processes in the State, which, while mooted to be the subject of review in the near future, currently act as a barrier to developing greenfields sites and upgrading existing generation sites.

In addition, we now note the substantial impacts of the global financial crisis on the availability of credit. Banks are now more cautious in lending, including to commercial clients and other banks. The available evidence suggests that banks are currently not willing to syndicate loans, so each bank becomes directly involved in the credit approval process. Each bank is only willing to lend a relatively smaller amount, so a larger number of banks must become involved in project financing.

These matters will need to be addressed if Government's climate change policies are to be effective.

B3. INVESTMENT TO MEET RELIABILITY STANDARDS WITH INCREASED USE OF RENEWABLES

1. Do you agree that investing to meet reliability standards with increased use of renewables in WA is not a significant issue and therefore should not be progressed further under this Review? If not, what are your reasons for reconsidering this position?

Synergy supports the AEMC's view that the introduction of the expanded RET is likely to lead to a significant increase in the amount of intermittent renewable generation, especially wind farms, connected to the South West Interconnect System (the SWIS). However, we have previously identified to the AEMC our significant concerns with regard to the future reliability of the SWIS as a result of this growth in intermittent renewable generation. This includes ensuring an appropriate mix of plant is achieved through the Reserve Capacity Mechanism. We view that for the Reserve Capacity Mechanism to function effectively it must secure sufficient back up quick start plant while not unduly affecting the efficiencies of existing baseload plants.

It is important that the market rules due not introduce distortions in the market and that neither positive or negative discrimination occurs with respect to any generation technology. The current capacity accreditation factor applied to wind generation is not in proportion to the contribution of wind to the peak energy requirement. This is a source of positive discrimination under the market rules that is problematic.

These reliability concerns are now subject to the consideration of the Renewable Energy Working Group, chaired by the WA Office of Energy, and established under the auspices of the WEM's Market Advisory Committee. Synergy supports the work of this group and anticipates that the resultant rule changes will act to address most of these concerns. We note however, the need to advise generation proponents as soon as practicable of impending changes to the Market Rules, at all times being highly transparent, such that these changes do not increase the level of regulatory risk already faced by proponents. In this regard we see a clear need to progress the work of the Renewable Energy Working Group as quickly as possible and therefore Government and Market Participants must be effective in allocating the necessary resources to do so.

Further, and as a reflection of the fact that the WEM is a small marketplace with limited participants, Synergy anticipates that there may be some substantial costs to modify market systems and processes to accommodate both the CPRS and the expanded RET and that this may potentially result in a substantial impost to the few Market Participants operating in this jurisdiction. Any cost increases must be managed in a way that protects the existing, thin, retailer margins. Without such protections, there is a real risk that retailers will exit the marketplace, resulting in a substantial lessening of competition. Synergy requests that the AEMC work with the OOE, the IMO and Market Participants to establish appropriate funding arrangements to facilitate further work and analysis on the impact of increased intermittent generators on the safe and secure operation of the WEM.

B4. SYSTEM OPERATION AND INTERMITTENT GENERATION

1. Do you agree that, given an increasing amount of intermittent generation, system operation in WA is a significant issue that should be progressed further under this Review? If not, what are your reasons for reconsidering this position?

Synergy agrees with the AEMC that the operation of several critical factors leads to an assessment that the existing energy market framework in WA may not result in the maintenance of a secure operating system that facilitates competitive energy markets. In the context of large variability in generation outputs, we identify the following factors:

- The potential for a large-scale increase in balancing arising from the CPRS and expanded RET in conjunction with the onus being placed on only one generator (Verve) to provide these services;
- The current concessions enshrined within the Market Rules for intermittent renewable generators (including those associated with deviations from dispatch plans);
- The limited mandate for ramp rate controls and self frequency keeping for intermittent generators; and
- The potential for reliability and efficiency reductions associated with downward dispatch of baseload thermal generators.

While some of these issues are being considered by the Renewable Energy Working Group, urgency of resolution is critical. Delays in providing Market Participants with advice as to the resultant Regulatory Change will affect the commerciality and risk profile of generators (existing and proposed).

2. Would any of the options identified in this chapter improve the efficiency of the balancing process in the WEM? In particular we would welcome views on:

- ***The practicality of introducing a competitive balancing regime?***

Synergy supports the transition to a more efficient approach for managing balancing services within the WEM. We have previously put forward the view that it is now an appropriate time to consider the implementation of a competitive balancing regime. This was a feature of the original market design, but was deleted because Western Power was not going to be disaggregated at the time the market design was finalised. This change was not reinstated following the Western Power disaggregation. Given that such a move would not come without a significant cost with regard to market system redesign, an appropriate first step would be to commission an independent cost benefit analysis.

- ***Other solutions (such as moving gate closure or introducing centralised wind forecasting) that could reduce the impacts in the balancing market of forecasting errors;***

Synergy has put forward the view that inaccurate and unreliable wind generation forecasts are likely to mean that generation dispatched in a trading interval is quite different to the generation that was scheduled and for which power system security analysis was carried out. This significantly increases the risk that power system security issues will emerge during dispatch.

Synergy has identified some potential for forecasting services that could be provided as a centrally managed, bureau service. This may enable the provision of more sophisticated forecasting techniques than those that can be economically developed and applied by individual wind generators. Synergy has discussed the potential for this service to be offered as a bureau service with both the Office of Energy (the OOE) and System Management. Alternatively, this service could be advanced by wind generators collectively (as a funded cooperative) or by another large portfolio player. Clearly, the commercial reliance on these forecasts by Market Participants creates a substantial risk exposure to be managed by the service provider. In light of this risk, we see some benefit in the independent assessment of the merits of such a proposal by Government.

With regard to the potential for changes to gate closures, Synergy has drawn to the IMO's attention a weakness in the current market design in that the Market Rules constrain the interactions between Market Participants by insisting that trading positions be determined in the morning of the day before the trading day. No flexibility to adjust these positions closer to real time is allowed. This is significant given that the majority of loads in WA are weather dependent. Greater flexibility would also allow retailers to adjust their requirements closer to the actual trading interval, based upon current weather forecasts. A closer gate closure is critical for wind generation, reflecting that wind forecasting accuracy greatly improves within 2 hours of the actual dispatch. It is Synergy's position that generators should be authorised to change their dispatch plans to account for changes to retailer's demand forecasts and to allow them to adjust their positions to reflect the implications of changed weather forecasts on generation capabilities. Amendments to the market structure to accommodate a gate closure closer to real time would address these concerns and add flexibility for generators in meeting a resource plan. We therefore see considerable merit in an evaluation of the costs and benefits of advancing the gate closure in the WEM closer to real time.

B5. CONNECTING NEW GENERATORS TO ENERGY NETWORKS

1. Do you agree that the connection of new generators to energy networks in WA is a significant issue and therefore should be progressed further under this Review? If not, what are your reasons for reconsidering this opinion?

Synergy supports the view that the connection of new generators to energy networks in WA is a significant issue and should be progressed further under this review. Most specifically, we have previously raised concerns as to:

- The timeliness of connections, including significant delays arising from Western Powers current approach to connection application queue management;
- The efficient management of transmission developments within the same location, including the operation of Western Power's current "unconstrained" approach to network planning;
- The clear need for a long term (30 year) blueprint of transmission needs and developments within the State; and
- The need for an efficient cost-reflective pricing approach for new connections.

2. Should incentives be provided for Western Power to ensure the timely delivery of connections, and, if so, how should risk be most appropriate shared under such a scheme?

Given the significant commercial risks experienced by customers and generation proponents alike, it is essential that appropriate commercial remedies be available to these parties when contracting for network access. Such remedies should include the right to seek damages from the network service provider in the event that the contracted network access is not delivered on time[3]. As a thin margin retailer and the advocate for some 970,000 residential, commercial and industrial customers, Synergy is strongly of the view that such costs should be recoverable from the network provider's margin and not bundled within the Network tariffs paid by customers. That is, end use customers should not be required to pay for penalties levied on the network service provider for failing to meet contracted connection obligations.

3. Could improvements be made to the queue management process in WA which do not conflict with the non-discrimination provision in the Wholesale Market Objectives?

Synergy has significant concern as to the ongoing management of the network access queue in WA. We view the current framework as inefficient and as hindering commercial certainty and increasing the investment costs of new generation proponents, which has a flow on effect to retail prices in this

[3] This was previously raised by the Economic Regulation Authority in their discussion paper: Annual Wholesale Electricity Market Report to the Minister for Energy, 5 June 2008.

State. Further, without redress queue management will see this issue remain a barrier to meeting WA's share of national climate change policy targets.

We view a need for urgent improvements in both the speed and transparency with which the network provider manages these services. Synergy is yet to see any evidence of this issue being considered by the network service provider and we therefore look to Government to establish a mandate for change. We view that removal of the current bottleneck within an acceptable timeframe, may require the development of some dedicated network assets by third parties.

B6. AUGMENTING NETWORKS AND MANAGING CONGESTION

1. Do you agree that network augmentation in Western Australia is a significant issue that should be progressed under this Review? If not, what are your reasons for reconsidering this position?

Synergy supports the view that the inability to resolve congestion in a cost-reflective manner, and therefore evaluate the costs of this against network augmentation, can result in inefficient investment in the transmission network and consequent delays to the connection of new generators. Further, the expanded RET is likely to exacerbate this situation by leading to a significant amount of renewable generation wishing to connect to the transmission network with low capacity factors but being unable to because of lack of capacity.

Synergy is concerned that the current arrangements for augmenting the shared network are not sufficiently flexible to deliver the desired market outcomes of Government's climate change policies within the desired timeframe.

If the State is to provide greater certainty for renewable developers, Western Power needs to have effective incentives to connect new generation and develop infrastructure at an early stage, ahead of firm commitments from generators. Development plans need to be transparent and to have been developed in dialogue with renewable (and other) generators, as well as the retailers who have the knowledge of the proposed load growth, so that projects are brought forward with full knowledge of network capabilities.

Setting out the likely programme of investment now, and beginning the initial design and preparatory work up to and including submitting planning applications, will allow an early start to be made on delivering new investments. This will require upfront investment from Western Power, for which they will need to achieve funding. How this is rolled into their regulated pricing regime needs to be fully considered. Synergy sees a need for Western Power's regulatory regime to be structured in such a way as to encourage Western Power to undertake more preparatory work on network extensions in advance of a firm commitment from a single developer; and to ensure greater involvement of project developers in the development of network investment plans.

Given the long life of transmission assets (potentially 40 years), the strategic planning undertaken by Western Power needs to take a view out to 2050. There is likely to be a need to further extend the boundaries of the SWIS to connect the more optimal renewable generation sites, particular in the lower great southern and mid west regions.

Developing a clear vision of the electricity network architecture that will support the necessary expansion of renewable generation and further developing our understanding of the challenges for its delivery and operation will be a crucial first step. Synergy calls for an urgent review of proposed developments and funding arrangements with the aim of supporting more cost effective and faster connection of renewable generation. The scope of this review should encompass all technical, commercial and regulatory arrangements for electricity transmission networks.

2. Would any of the options identified in this chapter improve the efficiency of network augmentation in the SWIS? In particular, we would welcome views on:

- ***The practicality of including an evaluation of congestion costs in planning network augmentations;***
- ***Other assumptions made as part of the planning process (such as the capacity factor of wind generation); and***
- ***The most appropriate locational signals for generation in the SWIS.***

In its previous submission, Synergy raised concerns as to the continuation of Western Power's "unconstrained" approach to network planning and development. The Technical Rules, underpinning the Western Power Access Arrangement, require Western Power to plan, design and construct its power system to ensure that power system stability and performance can be met under the worst credible load and generation patters and the most critical contingency events, without exceeding any component ratings or the allocated power transfer capacity.[4] This has driven Western Power to take a highly risk adverse approach to network planning, in that they will only connect new generators if the network can accommodate the full output of the plant. This approach means that an intermittent generator will have network capacity contracted for its full nameplate output. This is inefficient, particularly if there is a clustering of similar intermittent generators at a particular network point, given wind generation's low capacity factors. Synergy views this unconstrained approach to network planning as requiring urgent review.

Synergy has also previously highlighted the concern that the economic efficiency in the design and construction of the transmission system will only occur when the network and the WEM both send localised price signals to asset owners, which will incentivise them to construct at the point where the

[4] Frontier Economics Report: Review of Implications for Energy Markets from Climate Change Policies - Western Australian and Northern Territory Elements.

network and the market most require the generation. We see a clear need to review the locational signals present in the SWIS, in conjunction with the planning approach concerns identified above, to ensure that individual locational decisions, as well as the network augmentation, are fully efficient.

B7. RETAILING

1. Do you agree that the current inflexibility in the retail price regulatory arrangements in WA is a significant issue that should be progressed further under this Review? If not, what are your reasons for reconsidering this position?

The State Government currently sets retail tariffs exist in WA. The ability of the retail sector to pass through cost increases related to serving these customers is therefore subject to a decision by Government, and is almost wholly outside the control of the retailer.

The introduction of both the CPRS and the RET will create significant cost increases for retailers, which must be factored in to the tariffs. Failure to do so will put undue financial pressure on retailers and discourage competition due to the lack of headroom for new entrants. Further, a failure to have cost reflective time of use tariffs, will weaken the price signal to encourage changes in consumers energy usage levels and patterns.

A failure to have full cost reflectivity ultimately challenges the solvency of the retailer and hence could jeopardise their credit rating. The SWIS has largely relied on Synergy to underwrite new power stations through Power Purchase Agreements. If Synergy's credit rating is jeopardised then this would be highly problematic for the function of the market.

Synergy sees this risk of inadequate cost pass through as highly material, and sees a real risk of the erosion of the level of retail competition in this State should such pass through not be given effect.

2. How can further work undertaken in this Review be best incorporated with the Office of Energy's ongoing Electricity Retail Market Review?

Synergy supports a continuing dialogue between Synergy, regulators and Government policy makers on these issues.