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Energy Policy WA
Level 1, 66 St Georges Terrace
PERTH WA 6000

energymarkets@dmirs.wa.gov.au

Dear Energy Policy WA

CONSULTATION – MARKET POWER MITIGATION

Synergy welcomes the opportunity to provide a submission on Energy Policy WA's (**EPWA's**) consultation paper (**Paper**) regarding the proposed changes to the Market Power Mitigation (**MPM**) regime in the Wholesale Electricity Market Rules (**WEM Rules**).

Provided **below** is a summary of Synergy's comments and key concerns with the MPM regime proposed in the Paper. This is followed by a high-level summary of Synergy's understanding of the design framework¹ and Synergy's more detailed comments on the MPM design and on specific sections of the Paper.

Key Considerations

Overall, Synergy welcomes EPWA's proposed replacement of the existing SRMC-based market power mitigation test with the new 'competitive market' offer regime and its proposal to introduce a new three stage Market Power Test, designed to identify the potential misuse of market power by larger market participants. Synergy also supports EPWA's proposed approach to the Gateway Test, being the introduction of a static 10% concentration ratio based on capacity market share to determine participants with potential market power, and the alternative Constrained Gateway Test for facilities operating behind network constraints.

However, Synergy has reservations with some key aspects of the MPM regime, the most significant of which are:

- 1 *Lack of detailed information:* There is very little information in the Paper about how the new Offer Construction Obligation will be interpreted or applied by the ERA. It is also not proposed to provide any further clarity on this issue in the WEM Rules. Rather, these matters are left to be resolved at the ERA's discretion when it releases its Offer Construction Guidelines (**Offer Guidelines**).
- 2 *Revenue adequacy:* Synergy submits that the MPM framework needs to allow facilities to recover at least their efficient costs and a reasonable return on

¹ Synergy's detailed understanding of the MPM design framework is provided in the Annexure.

investment. In light of the ERA's recent review² finding that, as a result of increasing renewables, there is unlikely to be revenue adequacy in the WEM to sustain efficient investment, Synergy is concerned that there is no transparency or assurance that the ERA's Offer Guidelines will enable market participants to recover their reasonable costs from the energy markets and the Reserve Capacity Mechanism (**RCM**).

- 3 *ERA's power to issue penalties:* The proposed regime places substantial power and discretion in the hands of the ERA with respect to determining what conduct constitutes a misuse of market power. This is a matter of particular concern given the concurrent changes being proposed to the enforcement regime³.under which it is proposed that the ERA will not only have power to investigate non-compliance with the WEM Rules but will also be able to impose penalties and 'orders' (including for serious Category C offences) on market participants it considers non-compliant with its own guidelines (being the Trading Conduct Guidelines and the Offer Guidelines).
- 4 *Reversal of the onus of proof before ERB:* Although the new regime preserves a right to merits review before the ERB, this only occurs after the ERA has already decided a breach has occurred and has made orders/penalties; any review before the ERB is of the ERA's decision so the onus will be on the market participant to show why the ERA was wrong (rather than on the ERA to establish a breach as is the current position). Given that the ERA has access to all relevant market information, it is unreasonable to require the market participant to carry the burden of proving that it has not breached the WEM Rules.
- 5 *No clarification of market impact test:* The market impact test does not direct the ERA's enforcement activity to situations where a market participant's activities result in "sustained and substantial hindrance" to competitive market outcomes. There is no materiality threshold to prevent the ERA from prosecuting isolated instances of market power in a single trading interval or which result in minor market impacts. Nor is there a requirement that the ERA consider a 'real world' counterfactual when assessing market impact, taking into account the likely conduct of other market participants in response to the relevant bidding behaviour.

To mitigate some of the above concerns, Synergy recommends that EPWA:

- undertakes a robust and thorough consultation process on the Offer Guidelines and consider including a process for a market participant to challenge the ERA's interpretation on items within the Offer Guidelines prior to the ERA alleging the market participant has not complied with the Offer Guidelines;
- consider having an independent body (such as the Co-ordinator of Energy) approve the Offer Guidelines to ensure that consultation and proposed changes are carefully considered in the context of the day-to-day operation of the WEM;
- as part of the Co-ordinator of Energy's RCM Review⁴ process, consideration should be given to what costs should be reasonably recovered under the RCM versus the energy markets, and upon its completion undertake a holistic review of the WEM, to ensure that the MPM regime is fit for purpose and allows for appropriate recovery of reasonable and efficient costs of operating in the WEM;

² [D249712-WEM.Rep.2022---Triennial-review-of-the-effectiveness-of-the-Wholesale-Electricity-Market-2022.pdf](https://www.era.gov.au/~/media/ERA/Reports/2022---Triennial-review-of-the-effectiveness-of-the-Wholesale-Electricity-Market-2022.pdf) ([era.gov.au](https://www.era.gov.au)).

³ [Consultation: proposed changes to the WEM, GSI and Pilbara Regulations](https://www.wa.gov.au/government/consultation/proposed-changes-to-the-wem-gsi-and-pilbara-regulations) (www.wa.gov.au).

⁴ [Reserve Capacity Mechanism Review](https://www.wa.gov.au/government/consultation/reserve-capacity-mechanism-review) (www.wa.gov.au).

- reconsider giving the ERA authority to issue Category C breach and penalty notices. Alternatively, any ERB review should be a *de novo* review on the merits, as if no ERA decision had been made. This would effectively return the burden of proving breach to the ERA; and
- consider including in the WEM Rules a materiality threshold for breach of the Offer Construction Obligation and a requirement for the ERA to take into account what would occur in a workably competitive market in deciding whether a breach has occurred.

Overview of Proposed MPM Regime

The overall effect of the proposed MPM regime appears to be as follows.

- market participants caught by the Gateway Test, such as Synergy, must fail all three stages of the market power test before the ERA can commence a compliance investigation and enforcement action for breach of the Offer Construction Obligation;
- failing the three stages of the market power test does not result in the market participant being deemed to have breached the Offer Construction Obligation, nor is it a *prima facie* breach – it is simply an indication that the market participant *may* have breached the Offer Construction Obligation and the offer warrants further investigation by the ERA; and
- the Offer Guidelines determined by the ERA will define a subset of bidding behaviours that are deemed to comply with the Offer Construction Obligation.

Synergy sets out **below** its detailed submissions in relation to each component of EPWA's proposed MPM regime.

Detailed Comments

Design Framework

Three Stage Market Power Test

Synergy is broadly supportive of the use of the proposed three stage, non-binding market power test to identify the potential misuse of market power by larger market participants in the proposed MPM regime.

Synergy also welcomes the proposed introduction of the static 10% concentration ratio for the Gateway Test to determine market participants with potential market power.

Offer Construction Guidelines

While Synergy supports the proposal to replace the SRMC test with the new Offer Construction Obligation, there is very little information in the Paper about how the new test will be applied.

In particular, Synergy is concerned that, while the Offer Construction Obligation appears to provide a more realistic standard than the SRMC test, there is no indication in the Paper as to how the obligation will be interpreted or applied by the ERA. It is also not proposed to provide any further clarity on this issue in the WEM Rules. Rather, the application of the new Offer Construction Obligation is a matter that is left for the ERA's discretion when it releases its Offer Guidelines.

Synergy is concerned that, without clearer guidance in the WEM Rules, there is a risk that the ERA will continue to apply a theoretical economic approach to determine appropriate pricing standards for the WEM, rather than assessing market participants' pricing conduct in the context of a real-world 'workably' competitive market.⁵

For example, the ERA's timely report reviewing the effectiveness of the WEM⁶ found that there is unlikely to be revenue adequacy in the WEM to sustain efficient investment. Synergy would like to understand how EPWA and the ERA will take these findings into account in drafting the Offer Guideline and what costs market participants should reasonably be allowed to be recovered from the energy markets. Synergy submits that the MPM framework and WEM Rules and obligations need to allow facilities to recover at least their efficient costs and a reasonable return on investment. Synergy notes that the issue of revenue adequacy should be further explored as part of the RCM Review that is currently underway and EPWA should ensure that costs that are not able to be recovered in the energy markets can be recovered within the RCM.

To reduce the risk of a new interpretation that does not take into account real-world features of the WEM, Synergy urges EPWA to allow sufficient time and the opportunity for robust and thorough consultation on the ERA's proposed Offer Guidelines and allow for market participants to challenge the ERA's interpretation on items within the Offer Guidelines prior to the ERA alleging the market participant has not complied with them. Synergy suggests that an independent body (such as the Co-ordinator of Energy) should be considered to approve the Offer Guidelines to ensure that consultation and proposed changes by the ERA or market participants are carefully considered in the context of the day-to-day operation of the WEM.

Interaction of Market Power Test and New Enforcement Regime

While Synergy generally supports the three-stage market power test, there is insufficient detail in the Paper to enable market participants to understand how the proposed MPM regime, particularly the Offer Construction Obligation, will work in the context of EPWA's concurrent proposal to change the compliance and enforcement regime. These proposed changes enable the ERA to decide a breach has occurred and impose penalties and orders on the relevant market participant.

Synergy is concerned that, notwithstanding that the MPM regime does not deem non-compliance with the ERA's Offer Guidelines to be non-compliance with the WEM Rules, in circumstances where the ERA will be able to issue penalty notices without first applying to the ERB, the ERA's interpretation of the Offer Construction Obligation is effectively assumed to be correct for the purpose of the regime. The effect is also to reverse the onus of proving a breach of the rules before the ERB, as the market participant who has been issued a breach notice and penalty will need to show that the ERA erred in its decisions (rather than the ERA having to first prove a breach).

Offer Construction Obligation

Without seeing the precise drafting of the WEM Rules or the Offer Guidelines, it is difficult for Synergy to comment in any detail on the proposed obligation.

⁵ As French J held in *AGL v ACCC (No 3)* (2003) FCA 1525, the assessment of the competitive effect of conduct cannot rest upon speculation or theory and the application of competition law must operate in the real world. It must "be applied at a level which is *commercially* relevant or meaningful" [*emphasis added*].

⁶ [D249712-WEM.Rep.2022---Triennial-review-of-the-effectiveness-of-the-Wholesale-Electricity-Market-2022.pdf](https://erawa.com.au/D249712-WEM.Rep.2022---Triennial-review-of-the-effectiveness-of-the-Wholesale-Electricity-Market-2022.pdf) (erawa.com.au).

Synergy generally supports the fact that the obligation appears to now prohibit pricing that is above *and below* the pricing required by the Offer Construction Obligation (i.e. the new obligation appears to prohibit 'predatory pricing').

However, Synergy has the following concerns with the proposed Offer Construction Obligation:

1. There is no reasonableness or materiality threshold within the pricing obligation. Synergy considers the obligation should acknowledge a degree of imprecision which is inherent in *ex-ante* pricing by including an element of reasonableness. For example, the obligation could be drafted to require market participants to:

*“...offer prices in its Submissions that reflect the costs that a Market Participant without market power **would could reasonably** include in forming its profit-maximising offer.”*

2. The Stage 3 'Market Impact' test includes a requirement for the ERA to consider whether the proposed behaviour has resulted in 'inefficient' market impacts. However, the Offer Construction Obligation does not also contain a similar requirement for the relevant pricing behaviour to have resulted in inefficient market outcomes. The lack of such a requirement appears to make this aspect of the proposed regime internally inconsistent.
3. To avoid unnecessary regulatory burden, Synergy considers both the Offer Construction Obligation and the Stage 3 test should include a materiality threshold beyond 'inefficient market outcomes'. This is particularly important given the proposed changes to the enforcement regime whereby the ERA could, theoretically, impose orders (with no express limitation on the scope of those orders) on a market participant for a minor breach of the overarching obligation. Synergy notes that such materiality thresholds are generally applied in other jurisdictions with similar obligations.
4. In a similar vein, it is unclear the extent to which the obligation will be drafted to effectively define market power on the basis of a time dimension of a single trading interval, or at least a very short term, basis. Synergy considers that the obligation should be limited to apply only where the relevant bidding conduct results in "sustained and substantial" inefficient market outcomes. Synergy notes this proposal is consistent with the recommendation of EPWA's consultant, Sapere RBP, in its earlier expert report on market power mitigation⁷.
5. The drafting of the Offer Construction Obligation and the application of the Market Impact test may not be sufficiently broad to capture all pricing behaviours that are required to ensure there are no structural issues with the obligations in the WEM Rules so that, when taken individually, they effectively result in inefficient market outcomes.

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<https://www.wa.gov.au/system/files/2021-03/Consultant%20Report%20-%20Sapere%20RBP%20WEM%20Market%20Power%20Mitigation.pdf>, at 43

- a. It is unclear if the provision, in combination with the RCM, would create an economically inefficient 'missing money' problem for gas fuelled facilities associated with the additional costs those facilities incur from entering into the long term, efficient, firm fuel contracts required of them under the RCM.
 - b. Synergy considers it needs to be clear that it is permissible for a market participant to recover its costs during 'ramping' in the trading intervals before and after a facility clears for the provision of energy and Frequency Co-optimised Essential System Services (**FCESS**).
 - c. Similarly, Synergy considers pricing to avoid shut down and start-up costs should be expressly permitted where this results in a more efficient outcome for the market. For example, where a facility is in merit for morning and evening peak, an efficient outcome may be for the facility to ride-through low prices in the midday trough rather than decommit and recommit at a higher overall cost to the market. This same requirement should be considered for the FCESS markets to ensure that facilities are able to ride-through periods of low price where this minimises total costs.
 - d. There are many uncertain factors at the time each *ex-ante* market offer is made that form the assumptions underpinning the price offered. If any of these uncertain factors turn out to be different than expected, it is often not possible to reflect these changes in updated market offers. For example, the uncertainty of output from Distributed Energy Resources (DER) and large-scale intermittent generation can result in significant changes to dispatch outcomes (expected run times, loading levels and resulting price tranches). The uncertainty and risk of forecasting errors will increase as the capacity of DER and intermittent generation continue to grow in the WEM. Synergy considers that the Market Impact test must be applied sufficiently flexibly to enable market participants to account for these uncertainties and risks in their *ex-ante* market offers.
6. In light of the reversal of the onus of proof resulting from the ERA having power to issue a notice of breach and penalty decision, Synergy expects that it will be extremely difficult for a market participant to challenge an ERA breach decision and the imposition of any penalty. For example, in the event that the ERA investigated pricing conduct and concluded a breach had occurred and imposed a penalty, in order to challenge the ERA, the relevant market participant will need to prove that its offer price 'reflected the costs that a market participant *without market power* would include in forming its profit-maximising offer'. Proving this counterfactual is likely to be extremely difficult for a market participant without access to privileged competitor data regarding submissions during related or similar periods, and potentially market participant offer construction methodologies.

Other Issues

Constrained Gateway Test and FCESS

Synergy agrees with EPWA's proposal to run an alternative Gateway Test to identify portfolios with potential market power behind binding Network Constraints.

Synergy disagrees with the EPWA's decision not to apply the three-stage market power test to the FCESS markets. Based on the Paper, it appears that EPWA considers that the

Supplementary Essential System Services Mechanism (**SESSM**) is the appropriate primary MPM measure for FCESS markets. Synergy does not agree with this position on the basis that:

1. the SESSM measure is an *ex-post* solution that applies to perceived outcomes of market inefficiency rather than being aimed at preventing *ex-ante* pricing that is a misuse of market power; and
2. in any event, the FCESS markets, at least initially, will be significantly more concentrated and at risk of market participants misusing their market power than the Short Term Energy Market (**STEM**) and Real Time Market (**RTM**). Implementing the three-stage market power test would require the ERA to investigate pricing behaviours it considers to be non-compliant. This almost certainly increases the incentive for FCESS market participants to offer prices that comply with the overarching obligation (e.g. rather than risk pricing above those prices if, and only if, the ERA decides to subject them to the FCESS process).

Trading Conduct Obligation

Synergy generally agrees with EPWA's proposals in relation to the Trading Conduct Obligation.

However, Synergy considers that there is the possibility of an overlap between these obligations and the Offer Construction Obligation for some pricing behaviours. For example, it is at least arguable that offering a price that does not reflect the Offer Construction Obligation is also 'likely to mislead' and/or 'influence' market prices.

Synergy considers this potential for overlap should be rectified to ensure it does not leave open the ability for the intended design of the MPM regime to be undermined.

For example, it would appear to undermine the intended design of the three-stage market power test component of the proposed MPM regime if a pricing behaviour was exempt from ERA enforcement action under the three-stage market power test, but open to enforcement action as a result of the ERA considering the behaviour also breached the General Trading Obligations.

Price Caps and Floors

Synergy supports EPWA's proposal for a single price cap for STEM and RTM as well as its proposal for a \$0 floor in the FCESS markets.

Synergy reiterates its position from its recent submission⁸ to the ERA on the Minimum STEM Price Review that the price floor for the STEM and RTM is currently too low and is resulting in economically inefficient outcomes. Further, Synergy notes that the continued use of an excessively low Minimum STEM Price will result in increasing costs in the FCESS markets as facilities will need to recover their enablement losses of the Minimum STEM Price in the FCESS market. In addition, Synergy notes that it is reasonable to expect that this issue will be exacerbated as FCESS requirements will intensify in the future as a result of the increasing transition to cleaner energy (both large and small scale).

Given the rapid speed of the energy transition and the upcoming changes to the facility mix in the SWIS, Synergy disagrees with the proposal to review the price caps and floor every three years and proposes instead that they are reviewed every two years. For example, the

⁸ <https://www.erawa.com.au/cproot/22546/2/D244161-STEM.2022---Public-Submission---Synergy.pdf>.

planned retirement of Synergy's coal assets will see the Muja D and Collie facilities exiting the market within two years of each other.

Synergy considers that the WEM Rules should require indexation of the price caps to be undertaken in-cycle for inflation and fuel prices rather than this being something that could potentially be included in the WEM Rules. As has occurred in the eastern states, fuel prices can materially change within a short period and will become increasingly significant during the transition away from coal generation.

Conclusion

Synergy thanks EPWA for their work thus far and looks forward to further consultation with EPWA on the Information Paper expected to be released in September and on the Amending WEM Rules later in the year.

Yours sincerely

A handwritten signature in black ink that reads "Mark Chambers". The signature is written in a cursive style with a large initial 'M'.

MARK CHAMBERS
ACTING GENERAL MANAGER WHOLESAL

Annexure

Key elements of proposed Market Power Mitigation regime

At a high-level, Synergy understands EPWA's proposed MPM regime will include the following key elements.

1. Pricing Obligations: Changing the current overarching market power pricing obligation, that requires firms with market power to bid at or below 'SRMC', to a general obligation on *all* market participants to bid on the basis of prices "*which reflect the costs that a market participant without market power would include in its profit-maximising offer*" (**Offer Construction Obligation**). This obligation will apply to all market participant bids in the STEM, the RTM and the FCESS markets.
2. Trading Conduct Obligations: Refine the existing obligations that apply in the Balancing and Load Following and Ancillary Services (**LFAS**) markets that require the making of good faith offers, prohibit acting in a manner that may lead other market participants to be misled or deceived and prohibit influencing constrained prices and quantities in the Balancing Market. These obligations will apply to all market participant bids in the STEM, the RTM and the FCESS markets.
3. Price Caps: For the STEM and RTM, the current price floor will be retained, in addition to the higher of the two current price caps and the current 'Maximum STEM Price' price cap, which only applies to non-liquid fuelled facilities, will be removed. Market participants will be required to bid within these caps. For FCESS markets, new FCESS specific price caps will be introduced for FCESS market prices, and a \$0 price floor will be imposed.

Offer Construction Obligation – STEM and RTM

The new Offer Construction Obligation, for the STEM and RTM, will be supported by what is, in effect, an enforcement policy comprising a three-part market power test that creates 'safe harbours' for larger market participants' bids provided they follow non-binding guidelines to be published by the ERA. The core structural elements and objectives of each stage of the test will be prescribed in the WEM Rules but the details of how offers should be constructed to comply with the new Offer Construction Obligation will be set out in guidelines published by the ERA.

- a. Stage 1 of the market power test is the 'Gateway Test' which is the first objective screen to identify whether a market participant's portfolio is in a position to exercise market power. To provide suppliers with *ex-ante* certainty, EPWA is considering using a static concentration ratio, of 10% of total generation based on sent out MW, above which the ERA must assess the suppliers' offers against tests 2 and 3. Based on 2021 data, applying this measure, three portfolios (being Synergy, Alinta and Summit Southern Cross Power) are expected to be captured by the Gateway Test.
- b. Market participants who meet the Gateway Test progress to Stage 2, which is the 'Offer Assessment' test. Under this stage, the ERA will develop Offer Guidelines outlining the ERA's benchmark for acceptable bidding. In effect, the Offer Guidelines will be a proxy for the ERA's interpretation of what constitutes a competitive offer that satisfies the Offer Construction Obligation. The WEM Rules will specify the requirements for minimum content that must be included in the Offer Guidelines (such as what costs may be included e.g. fuel costs and opportunity costs) and will require the ERA to publish the processes it will undertake to conduct an Offer Assessment in a WEM Procedure - the Market Power Monitoring Protocol.

- c. Stage 3 is the 'Market Impact' test. Under this stage, the ERA is required to determine whether the relevant bids have resulted in "inefficient market outcomes". The WEM Rules will direct the ERA to consider market outcomes such as changes to market prices or payments and changes to quantities scheduled in respect of market participants in the STEM or dispatched in the real time market to determine whether offers have failed the 'Offer Assessment'. The ERA will be required to publish how it will undertake the assessment for the Market Impact test in a WEM Procedure.