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Energy Transformation Implementation Unit

Transmission via email to: energy.transformation@energy.com.au

MECHANISMS TO MITIGATE THE MISUSE OF MARKET POWER

Alinta Energy appreciates the opportunity to provide feedback on ETIU's proposed reforms to the mechanisms for mitigating the misuse of market power.

Alinta Energy supports a competitive, dynamic market founded on clarity, stability, and transparency. To ensure that the broad market design delivers greater efficiency and competitive outcomes, market participants must be able to compete actively in the market. Alinta Energy considers that overly restrictive bidding constraints undermine the benefits of effective competitive dynamics in the generation sector.

Rather than creating narrow and prescriptive ex-ante obligations, Alinta Energy considers that the WEM's market power mitigation arrangements should be redesigned to better reflect regulatory practice elsewhere in the world through enabling more flexibility, reducing current levels of intrusiveness, and seeking to achieve a sustainable balance between market power concerns and the need to maintain system adequacy and security of supply.

Given this, Alinta Energy does not support the ETIU's reforms as proposed.

Alinta Energy instead recommends that the framework:

- 1) Evolves to focus more on ex-post inspection as a priority over ex-ante restrictions. This can be achieved by linking ex-post inspection to bids exceeding "safe harbour" reference levels based on best practice in other jurisdictions, rather than prescriptive ex-ante obligations to follow construction guidelines because:
 - a) Overly prescriptive offer construction guidelines conflict with Market Objective (a) which is to promote the economically efficient supply of electricity.
 - b) As recently recognised by EPWA and the Brattle Group, it is not possible to prescribe how inputs should be incorporated in offers. Alinta Energy considers that attempting to do so risks preventing participants from recovering their costs and causing inefficient prices.
 - c) Offer construction guidelines may undermine the intent of the Energy Transformation Strategy to signal investment in Essential System Services.
 - d) Unlike ex-ante obligations, reference levels would avoid the risk of distorting how participants recover their costs and allow the market to discover the efficient price.
 - e) Reference levels would better support the stated principle of ensuring regulatory effort is proportionate to the potential cost of the misuse of market power.

- f) Reference levels would better support the principle of providing ex-ante regulatory certainty.
- 2) Does not employ the pivotal supplier test to impose different obligations on different participants at different times because:
 - a) Applying obligations based on dynamic market conditions may cause ex-ante uncertainty.
 - b) The different obligations applied to participants deemed to have market power should not serve to change these participant's bidding behaviour and therefore impact market outcomes.
 - 3) Does not implement a trigger for the SESSM when prices are deemed to be inefficient because:
 - a) Previous experience shows that determining efficient ESS prices risks significantly undervaluing these services.
 - b) The broad threat of intervention may undermine investor confidence and efficient price signals.
 - c) Increasing intermittent generation is rebalancing the value of ESS and energy. Intervention may inhibit this rebalancing and cause the market fail to signal the investment required – the intent of the ETS.
 - d) Having both a SESSM price trigger and price limit is duplicative.
 - 4) Recognise that market power mitigation rules should protect against prices being anti-competitively low.

Alinta Energy provides more detailed rationale for these recommendations below.

1. Why Alinta Energy recommends ex-post inspection should be linked to reference levels, not 'envelopes' based on offer construction guidelines

- a) Overly prescriptive offer construction guidelines conflict with Market Objective (a), which is to "promote the **economically efficient**, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system". Specifically:
 - The efficient dispatch of generation is distorted through any limitations placed on a Balancing Submission. Whenever a Market Participants modifies a market offer to conform with a prescriptive requirement, it has the potential to alter the dispatch pattern and misprice the marginal value of electricity.
 - Allocative efficiency is then distorted as electricity users respond to the distorted price.
 - The restrictions placed on Market Participants and the risks associated with distorted electricity prices change investment decision making, and thereby the dynamic efficiency of the WEM.
- b) Envelopes defined by ex-ante offer construction guidelines are more prescriptive, and may be more restrictive, than the current arrangements; even though Sapere and RBP have recognised a broader approach is required, and EPWA and the Brattle Group have recommended it is not possible to specify how offers should be constructed in more detail. This proposed approach may prevent participants from recovering their costs and cause inefficient prices, especially in the context of the new, increasingly dynamic WEM and reformed RCM.

Sapere and RBP's paper *Market power mitigation in the WEM* considers that the current SRMC ex-ante bidding obligations would be too narrow. This is because the recently reformed reserve capacity price significantly discounts the BRCP when the market is in surplus, meaning market participants may need to recover an increased portion of their total costs from energy and ESS markets. New entrants may need to recover even more costs as they may receive fewer Capacity Credits due to the network access quantity regime.¹

This is consistent with the EPWA and the Brattle Group's recent papers which advised against making the current ex-ante bidding obligations more prescriptive because:

- It would not be "possible to specify in the Rules any form of required mechanical relationship between gas prices and offers" because generators purchase gas under many different long-term contracts with bespoke terms and conditions².
- the WEM requires linear offers and "in order to recover its start-up costs but not over-recover them, the generator will need to form an expectation about the number of trading intervals it will be running, spread its start-up costs over these intervals, and set its offers accordingly."³

However, the proposal to implement safe trading envelopes defined by offer construction guidelines contradicts these findings: in place of rules requiring offers to reflect efficient costs, the proposal would implement further guidance and more prescriptive obligations for how participants should construct their offers.

Although these guidelines will not be in the rules, Alinta Energy considers they will have the same effect as if they were. This is because they will define the "safe trading envelope" and inform the ERA's assessment of whether the participant has misused market power. Participants would also be encouraged to demonstrate their offer construction method to the ERA to avoid the ERA determining their methods do not comply with their guidelines and bringing proceedings ex-post.

Alinta Energy considers that adding more prescriptive ex-ante obligations may cause inefficient pricing. As noted by Sapere and RBP, implementing regulations that are narrower than the current arrangements may lead to participants not recovering their costs given the reforms to the RCM. Additionally, Alinta Energy considers more flexibility is required because increasing intermittent generation means that there will likely be greater divergences between expectations and reality.

- c) Alinta Energy is concerned that like the current regulations used to determine what ancillary services prices participants ought to offer ex-ante, the safe trading envelope and guidelines may lead the regulator to expect participants to offer at prices that do not cover their costs.

Under the current ancillary services arrangements, prescriptive rules require the regulator to forecast the efficient prices of these services and these prices have failed to incentivise meaningful participation. Additionally, EPWA's modelling indicates that the revenue from these services should be much higher. The WOSP expects that revenue for contingency reserve raise services would be ~ \$50M in 2021 (assuming there is a market for these services), which contrasts with the regulated revenue of \$11,701,593 allocated for the equivalent spinning reserve service in 2019/20.⁴

To avoid undervaluing energy and ESS services, Alinta Energy recommends that a market be permitted to discover the efficient price, rather than have the offers prescribed by ex-ante guidelines. Alinta Energy considers that this is particularly important in the current context where increasing intermittent generation is rebalancing the value of ESS and energy. Alinta

¹ Sapere, RBP, [Market Power Mitigation in the WEM](#), March 2021, p20.

² The Brattle Group, [Implementing Recommended Improvements to Market Power Mitigation in the WEM](#), April 2020, p.13.

³ EPWA, [Directions Report on Clarifying SRMC and Market Offer Requirements](#), October 2020, p5.

⁴ Energy Transformation taskforce, [Whole of System Plan](#), August 2020, p.87.

Energy is concerned that more prescriptive ex-ante obligations would inhibit this rebalancing and cause the market fail to signal the investment required – the intent of the ETS.

- d) Alinta Energy suggests that reference levels and a “safe harbour” approach would avoid the issues in points (a), (b) and (c). By not attempting to prescribe how offers are constructed, the WEM will be more able to discover the efficient price of energy and ESS.

Consistent with best practice in other markets, Alinta Energy supports a safe harbour concept for bids that are within at least 20% of reported levels. Alinta Energy considers that adopting at least 20% as a level to trigger a review would be required as start-up costs are incorporated into bids within the WEM and so a larger level of volatility in bid levels is possible than in other jurisdictions which adopt 10%.

- e) Alinta Energy considers that the application of “safe harbour” reference levels is more likely to ensure that the framework supports the stated principle of making regulatory effort proportionate to any potential cost caused by misuse of market power. This is because ex-post inspection will be focussed on where prices have exceeded these reference levels, and not on maintain and monitoring compliance with prescriptive guidelines.
- f) Alinta Energy considers that reference levels would better support the stated principle of providing ex-ante regulatory certainty because:
- the proposed guidelines could not be exhaustive and there will be many scenarios where they cannot be applied.
 - as recognised by Sapere and RBP, there will be instances where participants will require more flexibility to recover their costs that are no longer covered by the RCM.
 - as advised by EPWA and the Brattle Group, it is not possible to specify cost components in the rules given a participant's circumstances in the market will change over time.⁵

By contrast, applying reference levels instead of ex-ante obligations will allow participants to identify whether they are trading within the reference levels regardless of the specific market conditions; how they are recovering costs not provided for by their capacity accreditation; and how they are calculating their cost components.

If the framework does retain the concept of a safe trading envelope defined by guidelines, Alinta Energy recommends that the responsibility for determining them should be separated from the responsibility for monitoring compliance with them. This is necessary to maintain to the current principle in the WEM of separating compliance monitoring from developing the regulations by which participants must comply.

2. Why Alinta Energy does not support using the pivotal supplier test to impose different obligations

- a) Alinta Energy is concerned that setting obligations based on whether a participant is pivotal in a given period will cause uncertainty as to what obligations apply at what time, undermining the principle of providing ex-ante certainty.
- b) Alinta Energy suggests that the added complexity of implementing the pivotal supplier test would not provide any benefits to efficiency because in an efficient market, behaviour should not change with obligations. Changing pricing behaviour based on different obligations as opposed to changing circumstances in the market may indicate that either the additional obligations imposed on a participant as it becomes pivotal are disrupting how it recovers its costs, or the participant is changing their behaviour based on whether they have market

⁵ EPWA, [Directions Report on Clarifying SRMC and Market Offer Requirements](#), October 2020, p4.

power.

3. Why Alinta Energy recommends that the framework does not include a price control that triggers the SESSM

- a) As stated in Alinta Energy's submission on the Tranche 1 Rules, Alinta Energy does not support the proposal to allow market intervention based on the ERA's view of whether prices have exceeded an efficient level. This is because:
- determining the efficient cost of ESS provisions is an inherently fraught, complex, and labour-intensive process. The ancillary services parameters review takes over six months, requires iterative market modelling, is perennially debated, and has failed to deliver outcomes that incentivise competition, despite the capability of existing facilities and the WOSP indicating that revenue should be much higher than current levels. As a process also aimed at determining efficient ESS costs, Alinta Energy is concerned that the price control trigger of the SESSM would be similarly unpragmatic and fail to improve competition despite high administrative costs.
 - The broad threat of intervention may also undermine investor confidence and efficient price signals. For example, a generator forecasting an opportunity in the ESS market may defer a decision to build new capacity or upgrade an existing facility, considering the SESSM may subsequently subsidise its competitors or it may miss the opportunity to receive payments itself. This undermines the intent of the ETS to use market forces to incentivise more efficient investment in ESS capacity.
 - increasing intermittent generation is rebalancing the value of ESS and energy. Failing to allow this rebalancing could fail signal the investment required.
- b) The ERA's internal price benchmark that triggers the SESSM duplicates the proposed ESS price limit.

However, if the ERA's SESSM trigger is retained, Alinta Energy recommends that the ESS price limit be removed to avoid duplication. Additionally, if either the trigger or limit is retained, Alinta Energy recommends that they recognise that Capacity Credits are not necessarily linked to ESS provision, particularly for technologies like storage. As a result, there may be no mechanism for ESS providers to recover their fixed costs, like there is Capacity Credits for energy providers. Alinta Energy is concerned that putting a limit or trigger for intervention on ESS prices may prevent these more efficient technologies from entering and disadvantage them compared to the conventional incumbents.

4. Why Alinta Energy recommends that the framework should protect against prices being too low

- a) As recognised by Sapere and RBP, anti-competitively low prices can be used to reduce competition. Their paper states that "decreasing offer prices below reasonable cost to decrease the market price with the effect of crowding out competitors, and then recovering losses through high prices later, or through inflated prices for other services."
- b) Alinta Energy considers that in industries with substantial government ownership, ensuring that government-owned entities will operate in a commercial manner tends to be a greater concern than market power leading to inefficiently high prices.

Conclusion

In conclusion, Alinta Energy does not support the proposal to implement additional prescriptive ex-ante obligations in the WEM Rules. Alinta Energy considers that this proposal contradicts recent findings that a broader interpretation of the current ex-ante obligations is required to avoid imposing ill-defined offer construction requirements; and allow participants to recover their costs. Further, Alinta Energy is strongly concerned that the proposed ex-ante obligations would inhibit the ability of the market to discover the efficient price. The consequential impacts to dynamic efficiency and investment incentives would come at a crucial time for the sector, as the ETS seeks to incentivise investment in new technologies that will support WA's energy transition. To avoid these outcomes, improve the operational efficiency of the regulations, and provide participants more certainty of their obligations, Alinta Energy recommends that the framework:

- Adopts safe-harbour reference levels in place of prescriptive ex-ante guidelines and the pivotal supplier test;
- Avoids imposing price control triggers for interventions in the new ESS markets; and
- Considers measures to mitigate the potential for anticompetitively low prices.

Thank you for your consideration of Alinta Energy's submission. If you would like to discuss this further, please contact Oscar Carlberg at oscar.carlberg@alintaenergy.com.au or on 0409 501 570.

Yours sincerely



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