

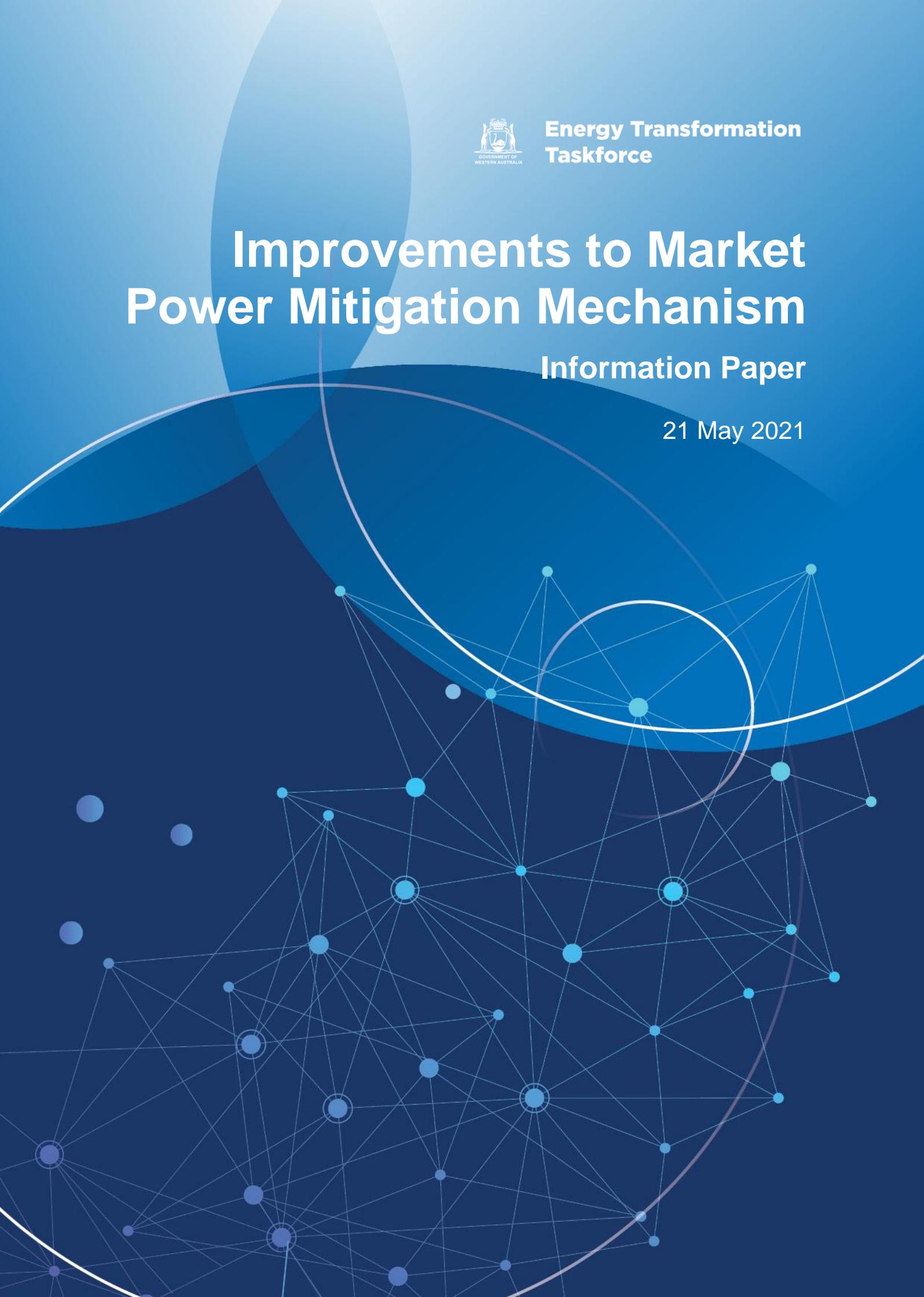


**Energy Transformation
Taskforce**

Improvements to Market Power Mitigation Mechanism

Information Paper

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Disclaimer

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The information, representations and statements contained in this Information Paper have been prepared by the Energy Transformation Implementation Unit.

It is provided to assist in understanding the proposed design of market power mitigation mechanisms in the new Wholesale Electricity Market (WEM).

Any views expressed in this Information Paper are not necessarily the views of the State of Western Australia, the Western Australian Government (including the Minister for Energy), or the Energy Transformation Taskforce, nor do they reflect any interim, firm or final position adopted by the Government for design of market power mitigation measures for the new WEM.

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1. Purpose

1.1 Energy Transformation Strategy

The paper forms a part of the work to deliver the Energy Transformation Strategy, which is the Western Australian Government's response to the transformation of the energy sector and its plan for the State's future power system. The delivery of the Energy Transformation Strategy has been overseen by the Energy Transformation Taskforce (the Taskforce), established on 20 May 2019 and disbanded on 19 May 2021. The Taskforce was supported by the Energy Transformation Implementation Unit (ETIU) – a dedicated unit within Energy Policy WA, itself a part of the Department of Mines, Industry Regulation and Safety.

More information on the Energy Transformation Strategy, the Taskforce and ETIU can be found on the Energy Policy WA website at www.energy.wa.gov.au.

This paper is prepared under the Future Market Design and Operation project within the Foundation Regulatory Frameworks work stream of the Energy Transformation Strategy (see Figure 1).

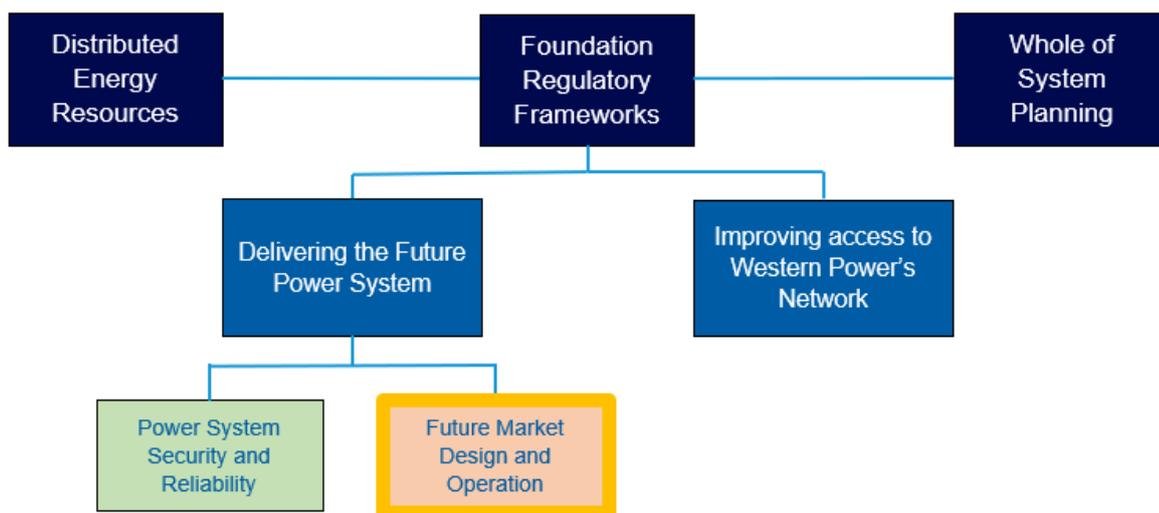


Figure 1 Energy Transformation Strategy work streams

A fundamental aim of the new market design is the establishment of appropriate market and regulatory frameworks to encourage investment in new technology types that will be needed to address power system challenges in a rapidly evolving WEM. Fast-response technologies, including storage and flexible power generation, will be increasingly required to maintain power system security as penetration of intermittent, renewable generation continues to grow. Ensuring market and regulatory frameworks enable participation of these facilities and provide appropriate compensation for their services is essential.

Market frameworks must also be designed to enable efficient entry and exit of participants, which will facilitate competition and put a downward pressure on the long-term cost of electricity to consumers.

The Taskforce has established the design of the new WEM through the new WEM Amending Rules gazetted in December 2020. Major components of the new WEM include:

- Establishment of Essential System Services (ESS) markets
- 5-minute dispatch intervals
- Move to a zero gate closure period
- Security constrained economic dispatch
- Synergy facility bidding
- Co-optimisation between energy and ESS
- Retention of the STEM
- Abolition of constrained-off payments
- Enhancement of the registration framework to remove entry barriers to new technologies and to increase flexibility of participation
- Changes to the Reserve Capacity Mechanism to recognise network constraints in the capacity credit allocation process with the introduction of a Network Access Quantity regime to promote investment certainty and provide location signals for new entrant capacity
- Establishment of a Supplementary Essential System Services Mechanism (SESSM) which can be triggered and overseen by the ERA if it observes and demonstrates inefficient market outcomes in any of the ESS real time markets
- Establishment of a Non Co-optimised ESS framework to ensure that any emerging need for new types of ESS services or network support services can be met in the future.

Given these very fundamental changes to the market design and arrangements it was timely for the Taskforce to undertake a holistic assessment of appropriate market power mitigation mechanisms in the new WEM. The need to balance demand and supply in real time gives rise to potential market power abuse in virtually all developed electricity markets. Hence, market power mitigation is a core element of energy market design. An effective market power mitigation regime should protect customers from industry participants extracting abnormal profits while supporting investment by allowing recovery of legitimate efficient costs.

In March 2021, the Taskforce released a Consultation Paper outlining a proposed high-level design for a market power mitigation regime. The proposed high-level design is provided in Appendix A.

1.2 Purpose of this paper

This paper outlines the Taskforce final endorsed high-level design of the market power mitigation mechanisms for the new WEM, following consideration of submissions to the Consultation Paper. It also provides the Taskforce's responses to specific issues raised in those submissions.

2. Background

2.1 The case for change

The WEM is a highly concentrated market, with a handful of large suppliers and purchasers, and market power is likely to be present in the WEM on a consistent and ongoing basis. As a result, competitive forces between market participants cannot be solely relied upon to deliver efficient market outcomes at all times. An effective suite of market power mitigation measures remains necessary.

The Taskforce remains of the view that the current market power mitigation regime is not fit for purpose in a dynamically evolving electricity market and that the deficiencies outlined below need to be addressed.

Deficiencies in the existing market power mitigation regime include:
Current market power mitigation mechanisms are largely reactive (ex-post) rather than pro-active (ex-ante)
The nature of the ex-post regime leads to regulatory uncertainty
Ex-post investigations are complex, resource intensive and time-consuming
There are lengthy delays between the regulator detecting inappropriate behaviours and remedies being delivered
The adverse outcomes for other market participants and consumers may persist for extended periods before the behaviour is remedied
The requirement for the ERA to refer findings to the Electricity Review Board has restricted the ERA's ability to be transparent about the content and progress of market power investigations
Limited transparency and availability of timely information make compliance with the regime challenging
Market participants lack clarity regarding their trading conduct obligations
There are no direct obligations on market participants to ensure compliance and report breaches

Several features of the new market will improve overall transparency and efficiency, however the opportunities for exercise of market power are also increased.

The design of the new WEM will enable supply of electricity at the lowest economic cost through security constrained economic dispatch. Gate-closure for all Market Participants will be reduced to zero (15 minutes for the first six months) to enable Market Participants to amend their offers to factor the latest information about power system conditions in their offers. This provides for efficient dispatch outcomes but can also increase the opportunities for exercise of market power.

In the short term, there will be a misalignment between the five-minute Dispatch Interval and the 30-minute Settlement Interval until 1 October 2025, which will increase opportunities for disorderly bidding as market participants try to cover any expected under-compensation from the time-weighted average settlement price.

The introduction of a constrained network access framework also means that occurrences of locational or transient market power may increase in a way that increases the opportunities for a market participant to earn economic rents when operating behind a constraint.

Synergy will now offer its facilities into the market individually, rather than the current portfolio approach. Although this improves the ability of other market participants to scrutinise Synergy's trading behaviour and adjust their positions accordingly, it also increases the potential for market power exercise.

The Taskforce considers that the SESSM will be a useful instrument to deter the exercise of market power in the ESS markets. If the ERA triggers the SESSM, it can require SESSM submissions from specific Market Participants, allowing it to examine the operating costs of facilities participating in ESS markets to assure itself that market power is or is not being exercised in a way that raises the ESS market price above its economically efficient level. If a new entrant can provide services at a lower cost than existing facilities, it may receive a SESSM award that contributes towards its fixed costs. Hence the presence of the SESSM provides a credible threat of new entry to temper market power exercise by incumbents. However, there could be considerable time between identifying undesirable market outcomes and the entry of a new SESSM Facility, so there is potential for inefficient market outcomes in the interim.

The combination of the new market design creating new opportunities for exercise of market power and the deficiencies of the current market power measures warrants improvements to the market power mitigation in the WEM.

The ongoing transformation of the energy sector and the rapid penetration of very low marginal cost resources in the energy market requires a carefully calibrated market power mitigation framework that does not constrain the recovery of efficient costs by providers and is not over-engineered for the relatively small SWIS market, while protecting consumers from extraction of abnormal profits by market participants with market power.

3. Stakeholder consultation

A consultation paper outlining the proposed design, included in Appendix A, of the market power mitigation mechanisms were released for consultation on Wednesday 31 March 2021 and presented to the Transformation Design and Operation Working Group on Monday 19 April 2021. Consultation closed on Wednesday 28 April 2021.

A total of six submissions were received from:

- Alinta Energy
- Australian Energy Council (AEC)
- Australian Energy Market Operator (AEMO)
- Perth Energy/AGL (Perth Energy)
- Shell Energy
- Synergy

The following section provides an overall summary of the submissions.

3.1 Summary of stakeholder views

The submissions presented a mixed response to the proposed high-level design. Perth Energy and Shell Energy supported the proposed ex-ante approach, subject to being consulted on more detailed development.

Synergy supported a market power mitigation framework that provides more ex-ante certainty on acceptable bidding behaviour but is concerned there should be accountability imposed on the Economic Regulation Authority (ERA) mandated in the Market Rules. It was also concerned the Pivotal Supplier Test (PST) will result in a focus on Synergy rather than other generators that, in its view, will also have market power.

Both the AEC and Alinta submissions did not support the Consultation Paper's proposed approach for various reasons, but primarily because they considered an ex-ante regime will add to uncertainty regarding legitimate cost recovery and undermine investment.

AEMO was concerned that the requirement on its market systems for provision of data to the ERA will delay design and development of the systems for the new WEM.

Perth Energy and Shell Energy supported the continuing need for market power mitigation measures and agreed that the consultation paper proposals set out a clear case for change. Similarly, they supported the broad direction of the proposals, and the scope and coverage of the proposed market power mitigation arrangements. They, however, did that with qualifications. They expressed concern that there was insufficient detail provided so far on the design and its application, and sought further consultation and opportunities for input during the detailed design and implementation process.

Synergy neither agreed nor disagreed with the proposals but sought a number of improvements and clarifications, and extensive future consultation and stakeholder participation in the development of the detailed design.

Only limited comments were made regarding the scope and coverage of the market power mitigation arrangements over the WEM's Short Term Energy Market (STEM), and real time energy and ESS

markets. Synergy recommended a holistic approach to market power mitigation across all revenue streams within the WEM including balancing, STEM, ESS and RCM. It expressed concern arising from its understanding that the new three-part market power tests would not be applicable to ESS.

There was widespread support for the concept that the arrangements should apply to predatory pricing (pricing below cost) as well as prices that exceed efficient costs.

Alinta Energy and AEC expressed concern that the new proposed design may not meet the stated objectives for the market. One concern was that the proposed ex ante obligations would inhibit the ability of the market to discover efficient prices and this would have consequential adverse impacts on dynamic efficiency at a crucial time in WA's energy transition.

There were mixed views on the proposed Safe Trading Envelope (STE). Several respondents considered that the components of the STE required further development and detail and that there should be clear guidance in the rules for the development by the ERA of the various components of the STE. A key concern related to the Offer Construction Guideline component of the STE, to be developed by the ERA. The main concern was that the development by ERA of the Offer Construction Guideline will result in an impasse over the definition of SRMC in relation to the allocation of start-up costs over multiple trading periods and determination of the value of fuel, and that compliance with the Guideline could potentially prevent facilities from recovering their costs.

Alinta Energy was concerned that the Offer Construction Guidelines would be more prescriptive and restrictive than the current SRMC rule, and proposed that instead of ex-post review of participant offer methodology (to determine whether the participant was inside a safe harbour), the ERA should compare participant offers to a pre-calculated reference price, and only investigate cases where offers exceed the reference price level by more than 20%.

Shell Energy and AEC expressed concern that ex-ante obligations (such as the proposed record keeping obligations) could be overly onerous and/or constrain efficient competition, while nevertheless permitting the exercise of market power. They were concerned that the regime could therefore impose higher than necessary costs, while not delivering the required benefits. A key concern was that the additional obligations on participants who meet the PST should not be overly burdensome.

AEC, Perth Energy, Shell Energy and Synergy recommended that the rules implementing the market power mitigation mechanism should give guidance to decisions by the ERA in developing and applying the new arrangements. Responses highlighted the need for the rules to provide guidance to the ERA in developing the new guidelines forming the Safe Trading Envelope and in the application of the effects test. This guidance should cover objectives, ensure detailed mitigation measures are proportional to the risks being managed and prescribe the process for consultation before final decisions are made.

AEC, Alinta Energy, Perth Energy, Shell Energy and Synergy expressed concern over the design of the proposed PST and sought to provide input into the detailed design of the PST, as well as its implementation in the market rules and systems.

The AEMO noted that the development of the PST will occur within the broader AEMO project for the design, implementation and operation of security constrained economic dispatch (SCED) and could potentially impact the resourcing requirements for SCED. AEMO recommended that the impacts on the development of new market systems to implement SCED should be determined in advance of decisions on the implementation of PST. Related to this, AEMO suggested detailed design of the PST would need to be completed by August 2021, if the PST is to be implemented from the scheduled start of new market arrangements from 1 October 2022.

3.2 Taskforce responses

There is some evidence that market concentration in the WEM is decreasing, due to a combination of a decrease in annual operational demand and the entry of new facilities. However, as noted in analysis by the ERA, market concentration in the WEM remains very high by comparison with similar markets. Synergy and most likely some other larger suppliers are likely to have ongoing opportunities to exercise market power; for instance as a result of the removal of current restrictions on rebidding. The potential for exercise of market power can be expected to deter new entry and hence is not self-correcting.

The comments calling for ex-post investigations instead of ex-ante obligations did not address the adverse effect of the lengthy delay between the detection of alleged market power abuse, a determination of whether abuses of market power had occurred and subsequent remedial action.

The Taskforce remains of the view that the current market power mitigation regime is not fit for purpose and that the deficiencies outlined in the Consultation Paper need to be addressed.

The existing market power mitigation mechanism in the WEM is largely reactive, based on ex-post investigations into the exercise of market power and the compliance with SRMC offer rules. The Taskforce remains of the view that the current regime does not provide Market Participants and potential investors with sufficient clarity and guidance on what is acceptable conduct. The current lack of guidance on what is acceptable bidding behaviour has given rise to uncertainty around what costs should be legitimately recoverable under the SRMC bidding requirement and there have understandably been calls for more clarity.

Further, ex-post investigation of potential breaches is proving expensive and time-consuming, requires the regulator to prove malintent on the part of the market participant, does not remedy adverse market outcomes in a timely manner, and adds to regulatory uncertainty. The limited guidance on how the regulator will detect market power exercise ex-post, may also discourage efficient behaviour in the market. The Taskforce considers that the ex-ante measures should be proportionate to the potential for market power exercise, and that the clarity (provided by the proposed Trading Conduct Guideline) on what activity is acceptable and what is unacceptable will significantly reduce the 'grey areas' that must be resolved by ex-post investigation and sanction.

The Taskforce therefore considers that market power mitigation measures with more emphasis on provision of ex-ante certainty regarding acceptable market conduct are necessary.

To achieve this the Taskforce has determined that the high-level design for market power mitigation will comprise the following elements:

- Reference to SRMC will be removed from the Rules.
- The Rules will define unacceptable trading conduct. This will be conduct which raises prices (and margins) above levels that would have arisen in the absence of market power being exercised.
- The ERA will be required to provide practical guidance on unacceptable trading conduct like that provided by the Australian Competition and Consumer Commission (ACCC) and the Australian Energy Regulator (AER).
- An objective test will be introduced to determine which participants are in a position to exercise market power. Additional requirements will be imposed on participants which pass this test.
- Price caps will be set for the energy and ESS markets. These limits should be high enough to enable participants to recover efficient costs and Energy Policy WA will need to redesign the relevant market rules to provide for this.

The Consultation Paper proposed introduction of a three-part market power test. In respect of a market power test, the Taskforce accepts the concern over the design of a PST and how it will be applied in practice. The Taskforce considers that more work needs to be undertaken on this aspect – whether a PST or some other measure – and leaves this open for further review and analysis. Because the Taskforce tenure expires on 19 May 2020 this ongoing work will need to be undertaken by Energy Policy WA, including consultation with the sector.

This further analysis should also include the two other proposed elements of the market power test to be conducted by the ERA – i.e., whether a pivotal supplier has operated within an acceptable safe trading envelope and an assessment of how an exercise of market power has affected market outcomes (“an effects test”) – both proposed in the Consultation Paper indicative design.

So whilst the Taskforce has decided that the Market Rules will adopt some form of objective test to identify participants with capability to exercise market power, it has not made any decision on what this test will be and has not mandated any requirement for the adoption of a safe trading limit for pivotal suppliers or adoption of an effects test as a component of any ERA ex-post review of conduct. Whether or not the design needs to incorporate Offer Construction Guidelines for pivotal suppliers and/or an effects test on conduct will need to be considered and determined by Energy Policy WA following further evaluation and consultation with market participants and the Economic Regulation Authority.

The Taskforce does however consider that the design should desirably provide ex-ante information to participants on how the ERA will assess possible market misconduct and specifically how it will assess whether a participant has exploited market power to raise prices above competitive levels. Energy Policy WA will need to determine whether ERA guidance on trading conduct obligations would be sufficient or whether additional processes and instruments such as an Offer Construction Guideline for pivotal suppliers are needed to achieve a more effective market power mitigation regime.

The Taskforce agrees that participants should be able to include efficient, variable costs in their offers to the extent that they would have done so in the absence of market power. The Taskforce also agrees that it is not appropriate for the WEM Rules to include a mechanical relationship between fuel prices and offers. The Taskforce disagrees, however, that an Offer Construction Guideline will add to uncertainty.

The proposed Offer Construction Guideline was intended to define a ‘safe harbour’ within which the ERA will not investigate. While it may not be possible for the guideline to cover every single conceivable circumstance and cost for every type of facility, it should be possible for it to cover most situations, including reasonable methods to incorporate estimates of run time, opportunity cost of fuel and stored energy, incorporation of enablement losses for ESS provision, and situations where low or high priced offers are acceptable. If a participant faces a situation or cost that is not addressed in the Offer Construction Guideline, under the proposals it would have the opportunity to voluntarily seek ex-ante clarity from the ERA.

The Taskforce considers that the “reference pricing” approach, proposed by Alinta Energy of the respondents, would require the development of even more detailed market procedures on exactly how the cost-based reference prices are determined. This would require solutions to the same challenges that the Offer Construction Guideline, proposed by the Taskforce, would face. However, it will also have the added complexity of determining specific prices for each service and each facility ex-ante, and consideration of a ‘safe harbour’ band both above and below the reference price (to deal with predatory under-pricing).

The publication of an Offer Construction Guideline would provide ex-ante information to participants on what, under the ex-post regime, would only become apparent after a potentially lengthy

investigation and appeals process. This is likely to increase rather than decrease opportunities for participants to evaluate and possibly contest the ERA's approaches and decisions.

The ex-ante measures in the WEM should not impose the significant intervention on offer prices applicable in the North American markets, even though by many measures the WEM is less competitive than those markets.

The Taskforce however notes the key issues raised regarding the need for more clarity regarding legitimate cost recovery in constructing offers and how this might be achieved through the Taskforce proposed design – in particular through guidance in Offer Construction Guideline developed by the ERA and direction in the rules over the scope of ERA's discretion. The Taskforce also agrees that the scope and coverage of market power regulation should cover all components of the energy market. Given the likely increase in the relative value of ESS markets, and opportunities for participants to shift revenue between energy and ESS markets, the Taskforce considers that it is important that the market power mitigation mechanism should apply to both energy and ESS markets, with suitable adjustments to reflect differences in the nature of the markets.

Whilst the Taskforce considers that ex ante guidance on offer construction is desirable, it agrees that this matter also needs more consideration. Accordingly, the Taskforce has determined not to include an Offer Construction Guideline or provision for a safe trading envelope as an absolute component in the high-level design pending further analysis and consultation by Energy Policy WA.

In respect of ESS, the ability for the ERA to trigger SESSM should act to deter manipulation of ESS offers. The Taskforce agrees that there is benefit in market discovery of efficient ESS prices and considers that Energy Policy WA should consider further the appropriateness of the ERA to publish its internal pricing benchmarks, which once approached or exceeded would prompt the ERA to require AEMO to trigger the SESSM process. This information would be useful to provide additional transparency and certainty to participants, but where such benchmarks may be uninformed by market outcomes this measure if introduced too early in the new ESS markets does invite inadvertent regulatory error.

With regard to participants deemed to have market power the Taskforce notes that the proposed record keeping arrangements mirror those that already exist in the National Electricity Market (NEM). Compared with the current WEM rule, the NEM rules contained in the current AER guideline include additional requirements relating to the time frames over which, leading up to a trading interval, new information is acquired, considered and acted upon in the form of any decision to amend a previous bid for a given trading interval. While there may be some additional data recording and retention cost, as in the NEM, these costs are offset significantly by the increased flexibility for Market Participants to respond to changing market conditions in the new WEM.

The next section provides the Taskforce's determinations in response to the stakeholders' views.

4. Taskforce determinations in response to stakeholder submissions

The Taskforce reaffirms certain components proposed in the Consultation Paper, while recommending that other components require more analysis and consultation by Energy Policy WA. The following table categorises the design elements into these two groups with some commentary on the rationale.

Component of the Proposed Regime	Rationale
To be reaffirmed by the Taskforce	
Reduce reliance on ex-post investigations	Aimed at improving regulatory certainty, is consistent with best practice regulation and to address some of the disadvantages of lengthy and costly ex-post investigations
Remove reference to SRMC from the rules	There have been repeated calls by participants to define SRMC, which is one of the key market power mitigation requirements in the rules. The present SRMC offer rules will be replaced with a requirement to make offers consistent with those that the participant would have made in the absence of market power.
Trading conduct obligations for market participants and providing guidance on what constitutes unacceptable exercise of market power	It is proposed to define unacceptable trading conduct as that which raises prices (and margins) above levels that would have arisen in the absence of market power being exercised. It will apply to both predatory pricing (pricing below cost) as well as prices that exceed efficient costs. The aim is to provide guidance on what constitutes unacceptable exercise of market power. The ERA will be required to release materials providing this guidance similar to that provided by the ACCC and the AER
Provide participants with an opportunity to engage with the Regulator to ensure their conduct is compliant	There were no strong objections to this part of the proposal. This does not relate to the costs which a participant may include in their offers, but to their trading conduct in certain circumstances which may not be covered by the ERA guidelines. Participants will be able to approach the ERA for clarification and the ERA would be required to respond to such requests and amend its published Trading Conduct Guidelines accordingly.
Introduce an objective test to establish whether a participant is in a position to exercise market power	The principle behind this test would be to adequately balance the interest of consumers with the legitimate right of participants to recover their efficient costs. The specific test is to be determined through further evaluation, as indicated below.
Additional obligations on participants who pass the objective market power test	Only those participants who pass the test should be required to implement additional processes and systems (including internal governance arrangements for trading conduct compliance monitoring and records keeping on changes to offer

	prices and quantities) to ensure compliance with their trading obligations.
Set energy and ESS price limits	<p>The objective is that price limits are high enough so that all participants can recover their efficient variable costs and the process for setting them employs a mechanism that reduces the effort and frequency of adjustment.</p> <p>This would involve Energy Policy WA redesigning the current rules to provide for this.</p>
<i>To be subjected to further analysis and consultation</i>	
The suitability of the proposed three-part market power test as an objective measure of market power	All submissions expressed concern over the design of the proposed PST and sought to input into the detailed design of the PST. The further analysis and consultation will need to include consideration of what guidance needs to be provided by the ERA in a Market Surveillance Protocol regarding the application of an effects test.
Identify a ‘safe trading’ envelope, including Offer Construction Guidelines	Under the Taskforce proposal this would combine trading conduct obligations in the WEM Rules together with ex-ante offer construction guidelines and trading conduct guidelines, provided by the ERA. There were concerns that the Offer Construction Guidelines would be more prescriptive and restrictive than the current SRMC rule. Further analysis and consultation need to be undertaken to determine the level of prescription required in the WEM Rules and the Offer Construction Guideline and establish the practicality and workability of this part of the Taskforce proposals.
Pre-approval of some offer parameters	Including, for example, internal market power mitigation controls or fuel costs. The concern is whether any discussions with the ERA will quickly reach an impasse, so the practicality of this measure needs to be examined further; including whether this component of the design is required, at least initially. Further consultation with stakeholders needs to be undertaken to establish whether it would be beneficial to participants.
Providing guidance to the ERA in the WEM Rules	Most submissions recommended that the rules implementing the market power mitigation mechanism should give guidance to decisions by the ERA in developing and applying the new arrangements. However, fettering the discretion of the independent economic regulator will need to be carefully considered.

Further to the above components of the high level design proposed by the Taskforce in its Consultation Paper, the Taskforce has determined that the following needs to form part of the final design.

The Taskforce considers that the market power mitigation surveillance framework should be governed and operate under an ERA Market Surveillance Protocol, developed under a head of power set out in the WEM rules. The relevant rules should clearly set out the objectives of the market power mitigation arrangements and would set out guidance to the ERA in developing and applying the new Market Surveillance Protocol, including its status as a market procedure. This part of the detailed design should also provide an opportunity to address respondents concerns that the market power test could be set either too high or too low.

The Taskforce considers that the rules should require, and provide guidance for, the development of a new Market Surveillance Protocol by ERA. The protocol, amongst other things, will set out the design and application of the appropriate market power test, and the process the ERA will follow regarding any investigations and enforcement actions related to its market power surveillance activities. The rules should also set out the associated process for development and consultation on this protocol.

The ERA decisions regarding aspects of the market power mitigation arrangements would be subject to the normal review processes that apply to any ERA decisions. In addition, in accordance with the new central governance rules, the Coordinator would monitor the market, including the ERA's surveillance, compliance and enforcement activities.

5. Implementation

In line with its considerations outlined in Section 5, the Taskforce considers that implementation of the market power mitigation regime needs to go through the following steps in accordance with the tentative timeframes indicated below:

Steps/Tasks	By
Energy Policy WA will continue to develop the detailed design of the market power mitigation regime for consultation with stakeholders.	July/August 2021
Stakeholders to be consulted on the draft detailed design through the Transformation Design and Operation Working Group	September/October 2021
Energy Policy to publish final Information Paper on the detailed design of the market power mitigation mechanism	End October 2021
Energy Policy WA to develop a detailed plan for implementation of the regime in consultation with the ERA and AEMO	End November 2021
Energy Policy WA will prepare draft Amending WEM Rules in the second half of 2021	November/December 2021
Stakeholders to be consulted on the Amending Rules through the Transformation Design and Operation Working Group	January 2022
The ERA will develop and consult on its trading conduct guideline(s)	December 2021 / March 2022
The ERA will develop and consult on the Market Surveillance Protocol	December 2021 / March 2022
AEMO and the ERA amending their systems to reflect the new regime	March 2022 / October 2022
Market Participants to determine whether amendments to their systems and processes are required, and if so, implement these amendments prior to Market Start	By October 2022
The Amending Rules commence	To be determined in consultation with AEMO and the ERA

The timelines above represent “best case scenario”. The Taskforce acknowledges however that these timeframes may not be realistic and more detailed planning will need to be undertaken by Energy Policy WA in consultation with key stakeholders to produce an achievable schedule of tasks. This is indicated in a specific task above.

Transitional arrangements may also be required to facilitate the development and implementation of the market power mitigation arrangements. For example, transitional rules may need to be put in place to enable the ERA to progress the tasks indicated in the above table. Such transitional arrangements/rules would need to be developed by Energy Policy WA and approved by the Minister by the end of 2021.

In different circumstances, ideally the improved market power mitigation mechanism would start at the commencement of the new market. However, it is likely that the existing rules related to the mitigation of market power would continue for a period beyond market start, to be determined by the detailed planning task indicated above.

Appendix A: What the Taskforce proposed to address the deficiencies

High-level framework design

This Appendix outlines the Taskforce indicative high-level design for a market power regulation regime as proposed in the March 2022 Consultation Paper.

The Taskforce endorsed the following objectives and high-level design components:

Reduce reliance on ex-post investigations. The changes were aimed at improving regulatory certainty and seek to address some of the disadvantages with the current reliance on a small number of lengthy and costly ex-post investigations. This includes providing guidance as to acceptable and unacceptable trading conduct, and imposing ex-ante obligations on market participants to monitor and report on their own trading practices.

Adopt an objective measure of market power. A simple market power test would be applied to the STEM, and real time energy and ESS markets. This would ensure that market power mitigation obligations and market surveillance focus only on the participants that meet a threshold defined by that test. This was intended to address the current lack of definition of “market power” in the rules.

The Consultation Paper proposed a **three-part market power test**, incorporating:

- *Ex-ante*: Determining the presence of market power through a “pivotal supplier test”.
 - This would ensure that market power mitigation obligations and market power surveillance are focused on the participants that meet a threshold defined by the test. For the threshold to be met, AEMO must dispatch one or more facilities of a Market Participant (“pivotal supplier”) otherwise demand cannot be met. A pivotal supplier test could potentially be automated in the AEMO’s surveillance systems and applied to the STEM, and real time energy and ESS markets.
 - The ERA would need to establish thresholds (e.g. incidence of offers meeting the pivotal supplier test over a set period) which, if met, would trigger certain market power mitigation obligations and market power surveillance by the ERA.
- *Ex-post*: Considering whether the participant is operating within the safe trading envelope; and
- *Ex-post*: Assessing how the market power exercise has affected market outcomes (“an effects test”). The objective is that the market power mitigation regime would be more concerned with avoiding the effects of the improper exercise of market power, and less concerned with the intent of participants.

Provide guidance on what constitutes unacceptable exercise of market power. The aim was to provide guidance on what constitutes unacceptable exercise of market power. It was proposed to define this as trading conduct that raises prices (and margins) above levels that would have arisen in the absence of market power being exercised.

Trading conduct obligations for market participants would be included in the WEM Rules and guidelines provided by the ERA, which:

- Build on 'good faith' offer obligations, which already exist in the WEM Rules, with additional guidance from ERA on what constitutes acceptable trading conduct;
- Provide that market submissions must be consistent with submissions that would have been made in the absence of market power, rather than directly requiring offers to be at SRMC as currently required by the WEM Rules; and
- Require participants with market power to have internal controls to support self-monitoring and prevention of potential market power exercise and to retain records to support the rationale for their offers.

Remove uncertain concepts from the rules. There have been repeated calls by participants to define SRMC, which is one of the key market power mitigation requirements in the rules. It was proposed that the present SRMC offer rules will be replaced with a requirement to make offers consistent with those that the participant would have made in the absence of market power. The objective is to avoid narrow interpretations of the SRMC rules, for example that the marginal cost is extremely short run. On this interpretation, the SRMC offer rule can be breached based on a handful of trading intervals or even a single trading interval taken in isolation.

It was proposed that the WEM Rules require the ERA to provide **offer construction guidelines** that set out how the ERA expects a participant would construct its offers. The WEM Rules would provide clarity on the types of costs that could be included in offers, while the ERA's offer construction guidelines will be required to include examples of efficient variable costs and how they would be incorporated in different situations. For example, the ERA would be required to provide clarity on how it will consider efficient long-term fuel contracts when considering fuel costs. These requirements were intended to ensure that when participants have market power their offers reflect SRMC.

With respect to the ESS markets, the potential for the **ERA to publish its internal pricing benchmarks**, which once approached or exceeded would prompt the ERA to require AEMO to trigger the SESSM process, to provide additional transparency and certainty to participants.

Identify a 'safe trading' envelope. This combines trading conduct obligations in the WEM Rules together with ex-ante offer construction guidelines and trading conduct guidelines, provided by the ERA.

A **concept of safe trading envelope** would be introduced that identifies acceptable trading activity for participants with market power, encompassing the above trading conduct obligations and offer construction guidelines. There would also be trading conduct guidelines, which would include a series of examples of conduct that is acceptable or not acceptable. Thresholds for defining unacceptable conduct would focus on the extraction of material super-normal profits via trading behaviour.

Provide participants with an opportunity to ensure their conduct is compliant. Market Participants would have the opportunity to engage with the ERA to clarify whether their trading conduct is compliant. This could, for example, include market participants providing information on input costs.

There would be opportunity for market participants with market power to voluntarily seek **pre-approval of some offer parameters** (including, for example, their internal market power mitigation controls or their fuel costs) by the ERA. Once a voluntary agreement is struck it would be binding on both parties.

Set energy and ESS price limits as a backstop mechanism. The objective is that price limits are high enough so that all participants can recover their efficient variable costs and the process for setting them employs a mechanism that reduces the effort and frequency of adjustment.

Energy and ESS price limits would be set as a backstop mechanism, including:

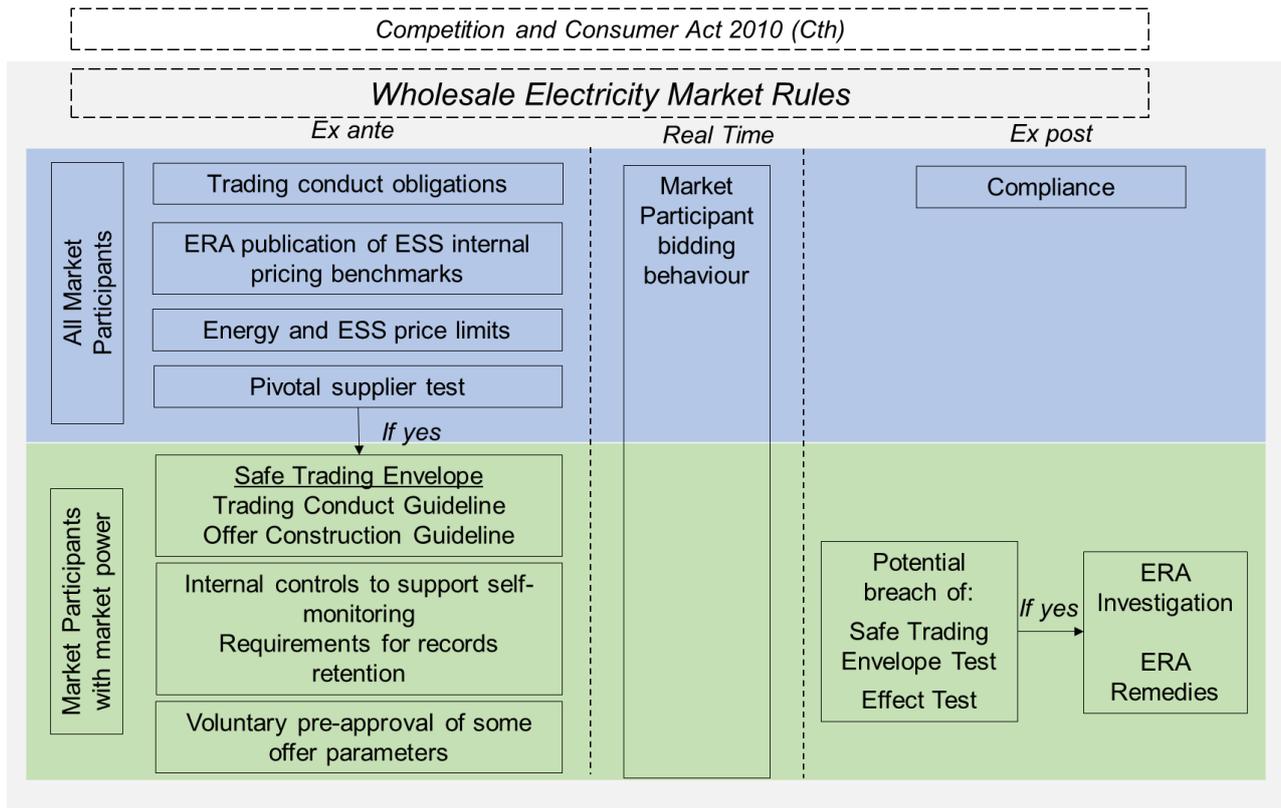
- The ERA would outline in a WEM Procedure how it will calculate a single energy price cap. This method must reflect that scarcity price signalling is the role of the RCM rather than the energy market. The ERA would set and review the energy price limit every three years based on the highest cost in the fleet. The process for setting the energy price floor will be unchanged.
- The ERA would also set ESS price limits every three years. Despite the SESSM, ESS price limits are needed to mitigate exposure to extreme prices as competitive alternatives may need time to bring to market. The ESS price limits could be based on the higher of either: (i) the energy price cap less the energy price floor – which represents the maximum opportunity cost at times of high energy demand; or (ii) the potential costs not recovered in the energy market when running at minimum generation in order to provide ESS. The ESS price floor will remain at zero as currently gazetted.
- A ten per cent margin would be added to the energy and ESS price limits and then rounded up to the nearest one hundred dollars.
- Market Participants can submit costs to the ERA as evidence price caps or floors should be amended.

As part of the detailed design of the market power mitigation mechanism, what remedies should be available to the ERA to incentivise compliant behaviour would need to be considered.¹

The Taskforce considers a periodic review of the effectiveness and efficiency of the above components should be undertaken by the Coordinator of Energy to ensure they remain fit-for-purpose and continue to balance the need for recovery of efficient costs while protecting consumers from inefficient market outcomes.

¹ In April 2020, the Taskforce endorsed the monitoring and compliance framework, as outlined in the Information Paper - <https://www.wa.gov.au/sites/default/files/2020-05/Information%20Paper%20-%20Monitoring%20and%20Compliance%20Framework%20in%20the%20Wholesale%20Electricity%20Market.pdf>

The proposed mechanisms are described at a high-level in the diagram below.



In 2019, the Commonwealth Government introduced Part XICA of the *Competition and Consumer Act 2010* to prohibit certain conduct relating to electricity markets, including electricity spot markets. In its Guidelines, explaining the general approach it will take in investigating alleged contraventions of Part XICA, the ACCC states that its view is that Part XICA currently only has limited potential application in Western Australia and that its approach to enforcement and compliance will be focused on conduct arising in the NEM.²

² See paragraph 1.6 of ACCC 2020 Guidelines on Part XICA-Prohibited conduct in the energy market - [https://www.accc.gov.au/system/files/Electricity Markets - PEMM - Final Guidelines.pdf](https://www.accc.gov.au/system/files/Electricity%20Markets%20-%20PEMM%20-%20Final%20Guidelines.pdf)