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Energy Transformation Taskforce  
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Dear Energy Transformation Taskforce

### **Proposals for changes to Market Power Mitigation Mechanisms**

Synergy recognises that fundamental changes in the rapidly evolving Wholesale Electricity Market (**WEM**) have triggered the need to undertake a holistic assessment of appropriate market power mitigation mechanisms in the new WEM, scheduled for commencement on 1 October 2022.

Synergy considers this assessment timely and necessary and welcomes the opportunity to provide comments on the consultation paper 'Proposal for changes to Market Power Mitigation Mechanisms' (**Consultation Paper**) published by the Energy Transformation Taskforce (**the Taskforce**) and the associated report 'Market Power Mitigation in the WEM'<sup>1</sup> (**Sapere Report**) prepared by Sapere Research Group and Robinson Bowmaker Paul.

Please see **enclosed** Synergy's submissions in response to the Consultation Paper and Sapere Report (**Submissions**).

Synergy's overarching view is that the Consultation Paper and Sapere Report are very high level and leaves for later specification all of the details of the proposed mechanisms and implementation that are critical for understanding the impact of proposed changes on Synergy and other market participants. The absence of such detail makes it challenging for Synergy to form a firm opinion on the proposals. For this reason, Synergy strongly urges Energy Policy Western Australia (**EPWA**) to undertake further detailed consultation on the proposals before proceeding with preparation of the Amending Rules.

For instance, limited detail has been provided on the development and application of the pivotal supplier test, used to screen the presence of market power. In particular, Sapere has recommended that further analysis be undertaken to determine how often participants other than Synergy are pivotal to inform the level at which the threshold should be set for the proportion of intervals that trigger application of the market power mitigation mechanisms.

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<sup>1</sup> <https://www.wa.gov.au/government/publications/proposal-changes-market-power-mitigation-mechanisms-the-new-wem>

From the Sapere Report, it appears there is a high risk that application of a single pivotal supplier may result in only Synergy being captured as the pivotal supplier. However, Synergy agrees that adoption of a multiple pivotal supplier test is unlikely to appropriately balance regulatory burden and benefits as, in the WEM, it is likely that all market participants would be regarded as pivotal during peak demand intervals.

As currently proposed, Synergy is not convinced the pivotal supplier test is the most appropriate measure for determining the existence of market power in a market with the size and characteristics of the WEM. The test is normally utilised in limited circumstances in markets which have a 3-part offer construction where participants have much greater certainty about their expected efficient costs and that they will be permitted to recover their efficient costs when they are dispatched.

Additionally, the test appears to be an over-simplistic assessment of market power and does not take into account important elements of market power including whether or not a market participant has the ability to profitably increase prices. This is a particularly important consideration when assessing the conduct of market participants such as Synergy who are both market generators and market customers. That is, in intervals where Synergy is a net buyer, it has no incentive to increase prices. To the extent the test does not make this distinction, it takes into account intervals that are not relevant to the existence of market power. Conversely, under a single pivotal supplier test, there is a real risk that market participants with relatively smaller amounts of capacity but have the ability and incentive to raise balancing market prices, will have free rein to trade with minimal regulatory oversight. Synergy therefore suggests that a more appropriate threshold test for sustained market power may be one based on a participant's share of sent-out generation.

Further, the establishment of the relevant pivotal supplier threshold to trigger the application of market power mitigation measures has yet to be contemplated, despite it being fundamental to the effectiveness of the market design.

In addition to concerns with the pivotal supplier test, Synergy is concerned that key objectives of the regime may not be achieved if they are not adequately captured in binding WEM Rules, but are left to the regulator's discretion through guidelines to be developed in which the regulator may adopt a narrower approach than that contemplated in the Directions Report Clarifying Short Run Marginal Cost and market offer requirements in the Wholesale Electricity Market (**SRMC Directions Report**)<sup>2</sup> and the Consultation Paper. That is, once the pivotal supplier test is satisfied, market participants deemed to have market power will be subject to compliance with mandated controls and a Safe Trading Envelope determined solely and unilaterally by the Economic Regulation Authority (**ERA**) with no mechanism for challenge or appeal.

Importantly, the Consultation Paper does not appear to contemplate any legally binding obligations on the ERA to reflect the intentions of the proposed market power mitigation mechanisms in their guidelines. This would not only defeat the purpose of this review but also render obsolete the regulatory efforts and costs directed towards conducting this consultation.

For example, the Consultation Paper acknowledges that fast-responding technologies, including flexible gas generators, will be 'increasingly required to maintain power system security as penetration of intermittent generation grows to higher levels' and the regulatory framework needs to provide appropriate compensation for their services to encourage further investment. However, it will be a matter for the ERA's discretion in development of its Offer

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<sup>2</sup> [https://www.wa.gov.au/sites/default/files/2020-10/Directions\\_Report\\_on\\_Clarifying\\_SRMC\\_and\\_market\\_offer\\_requirements\\_in\\_the\\_WEM\\_-\\_24.8.20\\_1.PDF](https://www.wa.gov.au/sites/default/files/2020-10/Directions_Report_on_Clarifying_SRMC_and_market_offer_requirements_in_the_WEM_-_24.8.20_1.PDF)

Construction Guideline “how it will consider efficient long-term fuel contracts when considering fuel costs”, which a market participant may not necessarily agree with, and more importantly, may not allow for pass through of actual efficient costs.

For the above reasons, Synergy’s strong view is that the ERA’s development of thresholds and guidelines should be bounded by core principles clearly set out in the WEM Rules.

Synergy has summarised its key concerns in the Executive Summary below, with further detailed comments set out in Sections 1 to 3 of the Submissions.

## **Executive Summary**

Key issues of concern with the proposals in the Consultation Paper and Sapere Report include:

- (a) undue focus on establishing a single pivotal supplier test, which is likely to under-regulate participants other than Synergy, potentially incentivising inefficient market participant behaviour which may result in material adverse impacts in the WEM;
- (b) uncertainty around a market participant’s ability to pass through actual efficient costs under the Safe Trading Envelope;
- (c) lack of obligations on the ERA to comply with principles underlying the proposed effects test;
- (d) ability for the ERA to designate participation in the Supplementary Essential Service Mechanism (**SESSM**) unencumbered; and
- (e) most importantly, absence of any legally binding obligations on the ERA to reflect the stated purpose of the proposed market power mechanism in its guidelines, thereby affording unilateral authority to the ERA to design, approve, review, implement and apply all critical components of the mechanism, with no avenue for market participant input or appeal.

Synergy confirms that this submission can be made public and has indicated where relevant, sections which are confidential in nature and should not be published. Should you require additional information regarding this submission, please contact Andrew Everett, Manager Energy Trading, at [andrew.everett@synergy.net.au](mailto:andrew.everett@synergy.net.au).

Yours sincerely



**KURT BAKER**  
**GENERAL MANAGER WHOLESAL**

## **SECTION 1 – SYNERGY’S COMMENTS ON THE CONSULTATION PROCESS**

- 1 The Consultation Paper does not address in sufficient detail the application of the high-level design on core components of the WEM Rules. For instance, several components of the Tranche 1 and 2 Amending Rules have been relegated for further review as part of this Market Power Mitigation workstream, yet there is no detail on what the intended changes to these aspects will entail.
- 2 Similarly, limited information has been provided on how the proposed three-part market power test will be implemented, including critical aspects such as the relevant pivotal supplier proportion threshold that will trigger the market power mitigation measures, making it challenging for market participants to formulate a position on the proposed changes.
- 3 In light of these observations, Synergy strongly supports EPWA’s intent to “conduct further consultation with the sector in the second half of 2021”. We understand this consultation is also intended to cover “implementation and transitional matters”. Synergy considers the opportunity for further detailed consultation essential to ensure procedural fairness, regulatory transparency and consumer interest.
- 4 The ‘devil is in the details’ and all aspects of the current proposal need to be thoroughly considered and subjected to scrutiny as they have the potential to critically impact market participants’ operating functions and compliance obligations. Therefore, Synergy suggests there should be two rounds of consultation, one prior to development of the Amending Rules, and recommends allowance of at least 20 Business Days for industry response.
- 5 Although cognisant of the tight timeframe presiding over these changes, Synergy considers it is clearly in the best interests of both consumers and market participants to allocate more time up front to creating a robust framework and to ensure the conceptual underpinnings and objectives of the regime are properly reflected in the Amending Rules, which will inevitably create increased clarity and assist in the ERA’s more efficient development of guidelines.

## **SECTION 2 – SYNERGY’S RESPONSE TO THE PROPOSED HIGH-LEVEL DESIGN**

6 Synergy’s submission responds to the following concepts presented in the Consultation Paper and Sapere Report:

- (a) Section 2.1 - Pivotal supplier test;
- (b) Section 2.2 - Safe trading envelope;
- (c) Section 2.3 - Effects test;
- (d) Section 2.4 - SESSM; and
- (e) Section 2.5 - Roles and responsibilities.

### **Section 2.1 – Pivotal supplier test**

7 As the first component of the three-part market power test, the pivotal supplier test will be used to identify the presence of market power and effectively tests “whether there would still be surplus capacity if a participant was to withdraw all of this **capacity**.” More importantly, **“a participant is a pivotal supplier if the total demand for a service could not be met if the participant did not submit offers for any or all of its facilities”**.

8 *Single pivotal supplier test:*

- (a) The Sapere report promotes the use of a single pivotal supplier test but it is unclear whether any qualitative analysis was performed to support this recommendation. Exactly how the test will be applied, including what will be the relevant threshold for the proportion of pivotal intervals that trigger the market power mitigation measures, and what are the intended outcomes of the test, remains unclear.
- (b) The Sapere Report also refers to the ERA’s review of the market effectiveness in 2018/19 and its finding that “Synergy is pivotal in the balancing market around 28% of the time”:
  - (i) Synergy queries whether the corollary suggests that 72% of the time, there are no pivotal suppliers. Alternatively, were there in fact another market participant/s which was pivotal in the balancing market 72% of the time?
  - (ii) Synergy suggests that the ERA should publish the calculation underlying its result so that market participants can understand how the test will be applied.

### **[Redacted content]**

- (c) The Sapere Report specifically recommends “that EPWA and the ERA conduct further analysis of how often participants other than Synergy are pivotal, as this will inform the level at which the threshold should be set”, yet there is no indication that this analysis has been performed. Synergy requests that the results of this analysis, including a summary of the number of intervals each participant is found to be pivotal, be published to market participants, together

with the methodology and rationale for setting the threshold so that market participants can properly assess the implications for the effectiveness and efficiency of the market and the likelihood that they will fall within the threshold.

- (d) Section 3.3.5 of the Sapere Report states that Synergy “is no longer the only participant with a portfolio large enough to be able to control prices. At times, Alinta Energy...and Southern Cross...will also have sufficient capacity to be able to unilaterally determine the market wide energy price”.
- (i) This suggests that if the pivotal supplier test is the only measure of market power, the implementation of a single pivotal supplier test gives rise to a real risk that other market participants with potential ability and incentive to influence market prices will have no restrictions on the exercise of their market power.

## 9 *Alternative suggestions:*

- (a) Synergy considers the application of a single pivotal supplier test overly simplistic, ineffective and therefore inappropriate for determining the presence of market power in the SWIS:
  - (i) A single pivotal supplier test which effectively focusses only on capacity, with complete disregard for energy share and network constraints, could provide large, cheap energy producers free rein to engage in rent seeking behaviour in the energy market (at both high and low prices). This is unlikely to be an efficient outcome, contrary to the market objectives of enhancing market efficiency and competition.
  - (ii) Synergy understands the test is normally utilised in limited circumstances in electricity markets which have 3-part offer construction where participants have much greater certainty that they will be permitted efficient cost recovery when they are dispatched.
- (b) Synergy recommends EPWA consider replacing the pivotal supplier test with a test based on assessing energy market shares to determine the potential existence of market power:
  - (i) For example, Synergy, Alinta and Southern Cross comprise of approximately 34%, 30% and 20% of energy market share respectively during the 12 months commencing March 2020. Introduction of a simple 5% market share threshold would therefore likely capture circa 84% generated energy.
  - (ii) This transparent methodology would also introduce a more appropriate and even-handed level of tension between the regulator and market participants as multiple market participants will be regulated.

## 10 *Recommendations*

- (a) Synergy **recommends** the Taskforce:
  - (i) shares analysis on the methodology, rationale behind and potential outcomes of the single pivotal supplier test and threshold proportion;

- (ii) ensures the outcome of a pivotal supplier test appropriately captures all market participants that have the potential ability to unilaterally determine prices; and
- (iii) assesses the benefits of utilising an energy market share threshold in lieu of a pivotal supplier test.

## **Section 2.2 - Safe Trading Envelope**

11 The second component of the three-part market power test, the Safe Trading Envelope, considers whether the bidding conduct of a market participant with market power complied with ERA guidance and agreed controls, comprising of Offer Construction, Trading Behaviour Guidelines and internal compliance controls.

### **12 *Prescription***

- (a) An appropriate level of prescription is necessary to ensure guidance is not too wide to be meaningless or inappropriate, and not too restrictive to prevent efficient market outcomes.
- (b) It is also important that guidelines developed by the ERA do not cause the same uncertainty and potential for inefficiency as the current Short Run Marginal Cost obligations. Synergy notes that EPWA's SRMC Directions Report and Brattle's paper<sup>3</sup> on SRMC bidding argued against prescriptive guidance on offers noting that:
  - (i) "it would not be possible to specify in the Rules any form of required mechanical relationship between gas prices and offers, except that a generator with market power should not exploit that market power to raise prices above competitive levels"; and
  - (ii) 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".

### **13 *Cost recovery***

- (a) Synergy is concerned that the Consultation Paper and Sapere Report ultimately leave to the ERA's discretion the issue of ensuring market participants are able to recover their actual efficient costs of providing electricity and contends that failure to achieve this outcome would be inconsistent with the market objectives that promote market efficiency and further result in exacerbating, rather than mitigating, deficiencies in the existing market power mitigation mechanism.
  - (i) As is recognised in the SRMC Directions Report, it is critical that market participants who procure fuel under long term firm contracts have the ability to incorporate in its offers their actual weighted average cost of

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<sup>3</sup> <https://www.wa.gov.au/government/publications/the-brattle-group-report-prepared-energy-policy-wa>

gas, subject to it having been an efficient contract at the time it was entered into;

- (ii) Unless this principle of cost recovery is expressly included in the Amending Rules, Synergy is concerned the ERA may continue with its existing view that the relevant market price is the opportunity cost of gas for the purpose of determining SRMC and that the relevant measure is the spot price from Gas Trading or the weighted average gas contract price as reported by the Department of Mines, Industry Regulation and Safety (**DMIRS**). These may not reflect market participant's actual efficient gas prices, taking into account a market participant's reserve capacity obligations, potentially resulting in revenue inadequacy; and
- (iii) Similarly, it is also important that market participants are able to properly reflect actual efficient transport costs, cycling costs and other critical costs in its offers.

#### 14 *FCESS markets*

- (a) Synergy's understanding is that there is no intention to adopt the proposed market power mitigation measures across the five Frequency co-optimised Essential System Services (**FCESS**) markets as the SESSM exists to govern market power in this domain.
- (b) However, Synergy considers that additional market power mitigation measures may be warranted for ESS markets:
  - (i) Using the load following ancillary services (**LFAS**) market outcomes as an example, strategic withholding of capacity has often resulted in Synergy being the marginal price setter, elevating costs at the expense of the consumer.
  - (ii) Current SESSM arrangements do not properly address this potential exercise of market power. Nor is it evident that the Safe Trading Envelope will address this issue.

#### 15 *Recommendations*

- (a) Synergy **recommends** the Safe Trading Envelope should:
  - (i) entitle participants to pass through actual efficient firm fuel contract costs, a principle that should be reflected in the WEM Rules;
  - (ii) reflect a level of prescription broad enough to not prevent efficient market outcomes but provide enough detail to not be meaningless; and
  - (iii) encompass guidelines on trading behaviour in relation to the strategic withholding of capacity in the ESS markets.
- (b) Synergy further **recommends** a holistic review of the market power mitigation measure across all revenue streams within the WEM (including the balancing market, short term energy market, FCESS and Reserve Capacity Mechanism)



is undertaken to ensure that, where appropriate, efficient cost recovery is achievable and the market power mitigation measures within the different markets are appropriate on an aggregate level.

### Section 2.3 – Effects test

16 The final component of the three-part market power test, the effects test, assesses whether market outcomes have been affected.

17 *Outcomes based test*

- (a) Synergy supports the underlying principles and approach of incorporating an outcomes-based test that would require the ERA to evidence that the exercise of market power had a “substantial and sustained effect on market outcomes” prior to undertaking further investigations.
- (b) In particular, Synergy approves of the requirement for the ERA to “compare market outcomes to a counterfactual scenario in which there was no market power exercise” and agrees that “while determining an appropriate counterfactual can be challenging, it is a core function of ex-post regulatory oversight”.
- (c) Synergy also commends the recognition that “although market power can exist and be exercised in a single trading interval, isolated instances of market power exercise generally do not have material effect on market outcomes” and promotes the idea that the ERA “should focus on situations where participant activities result in sustained and substantial hindrance to, or prevention of, competitive market outcomes”.

18 *Recommendations*

- (a) Synergy considers this a vast improvement on the current regime and **recommends** the Taskforce obligates the ERA to comply with the proposed framework by codifying these principles in the WEM Rules.
- (b) In particular, the requirement to conduct counterfactual analysis should be made explicit in the WEM Rules.

### Section 2.4 – SESSM

19 *ERA trigger of the SESSM*

- (a) The SESSM rules were developed and gazetted prior to the wholistic review of market power mitigation mechanisms in the WEM and there appears to be no consideration on the interrelationship between the application of the SESSM and the high-level design proposed for the energy market.
- (b) For instance, the Consultation Paper contends that “the SESSM will be a useful instrument to deter the exercise of market power in the ESS markets”. Synergy disagrees and considers this another example of enabling the ERA unfettered authority to control the pricing of plant owned by a party deemed to have market power:

- (i) Clause 3.15A.11 assigns the ERA power to designate facilities to participate in the SESSM, if, “in the ERA’s opinion, the Market Participant for the designated Facility has, or is expected to be able to exercise, market power in respect of the designated Facility, either alone or in combination with any one or more of the Market Participant’s other Facilities, for the applicable Frequency Co-optimised Essential System Service”.
- (ii) Further, clause 3.15A.34 allows the ERA to review the SESSM Awards and if it considers the market participant will not lower the cost to the market it may veto any or all of the proposed awards. It may also veto an individual award where it was not made in good faith or was incorrect.

## 20 *Recommendation*

- (a) Synergy recommends that the ERA’s role in the SESSM process is reviewed for consistency against the proposed market power mitigation mechanism. In particular, Synergy does not consider it appropriate to require market participants to participate in the SESSM purely based on the ERA’s “opinion” that a market participant “has or is expected to be able to exercise market power”.

## **Section 2.5 - Roles and responsibilities**

### 21 *ERA’s roles and responsibilities*

- (a) Prevalent through this Submission is Synergy’s concern on the lack of certainty and broad discretion that has been given to the regulator in relation to implementation of the proposed framework. Although Synergy acknowledges the Taskforce’s intent to defer the review of implementation until the second round of consultation, Synergy considers this issue too critical to not be addressed in this Submission.
- (b) Section 2.1.1 of the Sapere Report summarises some of the common characteristics of policy interventions present in effective market power mitigation frameworks. Of particular interest is 2.1.1(b), which notes that ‘a regulator role is established to ensure compliance with the regulatory framework’.
- (c) Synergy agrees with this concept and supports the ERA’s role to administer the mechanism. However, it is apparent that the drafting of the proposal affords the ERA excessive, and autonomous authority to establish every core component of the market power mitigation mechanism with no process for market participant negotiation or appeal.
- (d) In circumstances where the ERA is to have such wide discretion in the setting of the relevant market power threshold test and determination of the Safe Trading Envelope, it is essential that market participants have an efficient and effective process to initiate review of the ERA’s decisions. Without this, the lack of transparency and uncertainty around the relevant rules are likely to dissuade the entrance of new competitors.

- (a) It is inefficient and may act as a serious disincentive for future investment, to allow the ERA's authority to remain unfettered. Therefore, Synergy **strongly recommends** that the Taskforce:
  - (i) codifies the principles of the high-level design components of the market power mitigation mechanism in the WEM Rules to ensure alignment of the proposed mechanism and ERA developed guidelines;
  - (ii) codifies the high-level approach for determining ESS price limits in the WEM Rules to ensure the Taskforce's intention of revenue adequacy is met;
  - (iii) obligates the ERA to formally consult, and take into account, market participant feedback when setting market power related parameters;
  - (iv) introduces a mechanism to enable challenging and/or appealing Safe Trading Envelope determinations made by the ERA; and
  - (v) ensures adequate processes are in place to enable market participants to request changes to the mechanism if there are reasonable grounds to suggest the mechanism in place is no longer appropriate.

### **SECTION 3 - CONCLUDING COMMENTS**

- 23 Significant regulatory effort has been involved in producing these proposals and therefore significant consideration should be directed in ensuring an efficient, effective, and robust mechanism is introduced. Therefore, Synergy strongly urges the Taskforce to reconsider the proposed high-level design in relation to each of the above matters.
- 24 If the issues raised in this Submission are not adequately addressed, this is likely to result in:
- (a) under-regulation of market participants, incentivising inefficient rent seeking behaviour which may result in material adverse impacts in the WEM;
  - (b) exacerbating, rather than mitigating, deficiencies and inefficiencies in the existing market power mitigation mechanism;
  - (c) failing to satisfy the market objective of increasing market efficiency, encouraging competition and reducing the long-term cost of supplying electricity; and
  - (d) providing the ERA undue discretion to unilaterally control the market power mitigation mechanism,
- resulting in the implementation of a market power mitigation framework that, in Synergy's view, is likely to be less effective, less objective, more costly and excessively more onerous than that currently in force.
- 25 Synergy maintains that further details are required for it to form a position on some matters and Synergy may amend its stance at any time.
- 26 Synergy looks forward to the further round of consultation in the second half of 2021 and will be available to discuss in further detail any aspects of the points raised above.