

ECONOMIC REGULATION AUTHORITY

Discussion paper: 2015 annual report to the Minister for Energy on the effectiveness of the EGRC regulatory scheme



Executive Summary

Context

Regulation 48(1) of the *Electricity Corporations (Electricity Generation and Retail Corporation) Regulations 2013* (**regulations**) requires the Economic Regulation Authority (**ERA**) at least once a year to review the operation of the EGRC regulatory scheme for the purpose of assessing its effectiveness.

The ERA must provide a report to the Minister for Energy (**Minister**) based on the review, not later than two months after the review is completed. The ERA has indicated it will take into account stakeholder views in the preparation of its report to the Minister.

The ERA published a notice on 11 November 2015 inviting public submissions from interested parties on issues that will assist the ERA in undertaking its second review.¹ Further, the ERA has prepared a discussion paper to guide submissions to the review.²

Scope

The scheme the subject of the review consists of the regulations, the *Segregation and Transfer Pricing Guidelines 2013* (**guidelines**) and the *Electricity (Standard Products) Wholesale Arrangements 2014* (**standard products**).

Key issues

The key scheme issues from Synergy's perspective are:

1. The ERA needs to take a considered view as to whether the various regulatory arrangements are fair and reasonable to both market participants and Synergy in conducting the review of the scheme's effectiveness.
2. The ERA should adopt an evidence based approach when considering stakeholder submissions regarding Synergy's ring fencing conduct.
3. The regulations should specify scheme objectives to enable the effectiveness of the scheme that has been established to be assessed.
4. The statutory review requirement is not a conceptual review of what could or should have been put in place but on the effectiveness of what actually has been established by the state government.
5. The scheme is not designed to ensure private participant's interests are promoted, particularly to the detriment of Synergy's own commercial interests.
6. The scheme could be improved by providing the Office of the Auditor General and ERA with discretion to extend the audit or review period if Synergy demonstrates a good level of compliance or the review has determined the scheme to be working effectively.

¹ ERA notice: <https://www.erawa.com.au/cproot/13953/2/2015%20EGRC%20Discussion%20Paper%20%20%20Notice.pdf>

² ERA discussion paper: <https://www.erawa.com.au/cproot/13952/2/2015%20EGRC%20Discussion%20Paper.pdf>

7. Various matters need to be taken into account when assessing wholesale and retail market competition.
 8. The standard products regime meets the state government's high level design objectives including price discovery and is considered to be operating effectively. The standard products regime is not intended to be a benchmark of a competitive price.
 9. Synergy does not consider there to be sufficient evidence to move from the current standard products buy/sell spread.
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1. INTRODUCTION

The state government is committed to sustained private sector participation and competition in the Western Australian electricity market. Significant market change has occurred through the electricity market review and will continue to do so over the coming years, including full retail competition. As the government owned corporation the subject of the scheme, Synergy recognises the design intent is to facilitate the transition to a more competitive market via regulatory constraints so that Synergy does not unduly preference its retail and generation business units over third party retailers and generators specifically in the provision and use of sensitive information.

Although Synergy has a prominent role in the generation and sale of electricity, it would be unfair to attribute the current state of the electricity market solely to its structure. These market limitations have been well documented and more recently have been subject to significant media coverage on such matters as the need for retail tariff reform, wholesale electricity market restructure, changing electricity demand, greater consumer appetite to invest in alternative energy technologies and appliances. We also note continued government ownership of the state's electricity utilities has been topical.

Synergy considers the primary focus of the ERA's 2015 review is to once again assess the degree to which the scheme results in an operational framework that enables Synergy's business units to achieve arm's length dealings in relation to the wholesale supply or acquisition of electricity and wholesale electricity products. In doing so, the ERA needs to take a considered view as to whether the various regulatory arrangements are fair and reasonable to both market participant and Synergy.

We also recommend the ERA adopts an evidence based approach to stakeholder submissions whereby market participants should be required to substantiate to the Authority their assertions regarding Synergy's ring fencing conduct.

2. FRAMEWORK FOR AN EFFECTIVE EGRC REGULATORY SCHEME

In this review, the ERA intends to review how effective the Scheme has been in achieving a level playing field and providing confidence to market participants. The ERA would welcome any information from stakeholders in relation to their practical experience of the Scheme or any suggestions stakeholders may have in relation to improving the Scheme.

2.1 EGRC scheme objectives

Synergy is required to implement and comply with a range of legislative requirements which have no specific or measurable policy goals. The lack of clarity around the EGRC scheme policy objectives makes it difficult to review and assess its effectiveness. The scheme could be improved by amending the regulations to specify a series of objectives to enable their effectiveness to be assessed.

2.2 Review scope

In Synergy's view the review scope is limited to considering the operation of the scheme for the purpose of assessing its effectiveness. The statutory review requirement is not a conceptual review of what could or should have been put in place but on the effectiveness of what actually has been established by the state government. In that regard Synergy questions how the ERA will evaluate the scheme's effectiveness in terms of achieving a level playing field and providing confidence to market participants. For example the ERA considers there "needs to be confidence that the scheme will ensure efficient pricing outcomes"³ however, the scheme itself does not prescribe this outcome. As Synergy stated earlier in this submission, the review must be evidence based with any ERA recommendations substantiated by fact and not opinion or view.

³ "2015 Annual Report to the Minister for Energy on the Effectiveness of the EGRC Regulatory Scheme" page 6.

2.3 Level playing field

The ERA is of the view “the primary purpose of the Scheme was to mitigate the increased potential for exercising market power, which arises due to the merger of Synergy, by ensuring a level playing field for competitors and new entrants, in order to facilitate competition.”⁴

Further, the ERA considers “achieving a level playing field” means:

- third party competitors are able to buy or sell wholesale electricity on the same or similar terms to the RBU or GBU; and
- the RBU or GBU do not have access to information that is held by the WBU, that is not available to other retailers or generators, or is not available to them in an easily accessible form or in a timely manner.”⁵

The concept of a level playing field should equally apply to Synergy. The state government expects Synergy to act commercially and efficiently in the sale and purchase of wholesale energy within its business whilst acting consistent with the constraints imposed by the regulations. For example, the regulations prohibit Synergy’s wholesale business unit (**WBU**) from disclosing retail restricted information to its retail business unit (**RBU**) and generation restricted information to its generation business unit (**GBU**). Synergy notes however, the ERA appears to be adopting a broader view of information sharing limitations (refer second dot point above) than is prescribed in the regulations.

Synergy also notes the scheme is not designed to ensure private participant’s interests are promoted, particularly to the detriment of Synergy’s own commercial interests. The scheme clearly requires Synergy to pursue its own commercial interests and Synergy is legitimately entitled to do so, but within the confines of the scheme established by the state government.

The scheme could be improved by the regulations recognising Synergy’s legitimate business interests whilst being subject to the obligations imposed under the scheme.

2.4 Regulatory burden

From Synergy’s perspective it has responded to the EGRC scheme requirements seriously and responsibly. The ring fencing regulations has constrained Synergy’s operations in terms of our ability to communicate and exchange information between specific business units and imposed additional cost and regulatory burden. Examples include creating a secure office location for WBU, infrastructure to support and maintain standard product arrangements, training requirements, the cost of establishing and maintaining a ring fencing compliance framework and resource allocation to participate in statutory audits and reviews⁶.

The requirement to undertake two audits and an effectiveness review each year irrespective of audit or review outcome can result in unnecessary regulatory burden. The scheme could be improved by providing the OAG and ERA with discretion to extend the audit or review period if Synergy demonstrates a good level of compliance or the review has determined the scheme to be working effectively.

⁴ “2015 Annual Report to the Minister for Energy on the Effectiveness of the EGRC Regulatory Scheme” page 3.

⁵ “2015 Annual Report to the Minister for Energy on the Effectiveness of the EGRC Regulatory Scheme” page 6.

⁶ At the time of drafting this submission, Synergy has been subject to three independent Office of the Auditor General (**OAG**) audits, one ERA effectiveness review and at the time of drafting this submission is currently participating in the fourth OAG audit and the second ERA effectiveness review. Under the regulations, Synergy is effectively participating in a regulatory audit or review at any point during the year.

3. ASSESSMENT OF WHOLESALE AND RETAIL COMPETITION

The ERA invites stakeholders to comment on what factors should be considered in its review of retail and wholesale competition and would welcome any information stakeholders may be able to provide.

Competitive markets are always preferable to regulation and Synergy is supportive of the creation of greater competition in the wholesale electricity market (**WEM**) and retail market. Synergy views the scheme as transitional in the lead up to the reforms being considered as part of the electricity market review, including full retail contestability. Synergy expects once the state government has determined effective competition exists, the scheme will cease.

Wholesale competition

When assessing wholesale competition the ERA should take into account what is driving the current state of the wholesale market, including key topical issues such as the current over supply of capacity.

Retail competition

Since the merger in January 2014 competition in the contestable electricity market in our view has been the most active in terms of churn and contracting. When assessing retail competition the ERA should take into account:

- Retail market definition and associated customer segments i.e. large use contestable customers, small use contestable customers, residential and business franchise customers;
- The number of customers churning between retailers;
- Demand and supply;
- New retail entry models;
- The number of existing retail licence holders;
- Why so many retailers supply large use customers only;
- Regulated tariffs, fees and charges and associated eligibility criteria;
- Customer satisfaction in terms of the number of internal and external customer complaints;
- Why customers churn (price, service, debt avoidance etc);
- Level of contract and price disclosure and discovery;
- The status and timing of electricity market review specifically full retail contestability metering contestability and retail price regulation; and
- Retailer obligations to offer to supply.

Synergy also draws the ERA's attention to the Australian Energy Market Commission's "2015 Retail Competition Review – 30 June 2015" report⁷ as a useful reference point for assessing competition in electricity retail markets and the Authority's own annual retailer performance reports.

⁷ <http://www.aemc.gov.au/getattachment/56a8c56f-0aeb-48cc-9097-9f2b5e645428/Final-Report.aspx>

4. STANDARD PRODUCTS

The ERA would welcome any information from stakeholders in relation to their practical experience of the Standard Products or any suggestions stakeholders may have in relation to improving the Standard Products, particularly in relation to the buy/sell spread.

In assessing the standard products regime (“**regime**”) Synergy considers it is important to revisit the original objectives, as set out in the state government’s “Standard Product Regime – Market Participant Briefing, 9 April 2014⁸”. The regime was seeking to:

- Function as a price-discovery mechanism; and
- Provide a simple alternative to customised products.

The regime was not intended to create a market or act as a benchmark for a competitive price.

Synergy considers the regime meets these high level objectives. There is evidence that the regime functions as a price-discovery mechanism and it is clear that standard products provide a simple alternative to transacting in customised products.

The level of transparency with respect to standard products is set by the regulations, not Synergy. The standard products design intent is for published online prices, together with completed transactions. Consistent with the regulatory requirements and the on-line purchase and sell prices, this provides tangible evidence of price discovery.

Synergy is aware that the ERA considers that price discovery can only be achieved if the quantity and range of products offered adequately reflects the typical requirements of retailers⁹. However Synergy contends that in the event the standard products price is not used as the basis for retail customer pricing, this does not necessarily mean there is no effective price discovery. There are potentially many reasons why the standard products price may not be being used as the basis for pricing, including that retail market participants already have sufficiently contracted energy, require different volumes or deal duration, or are sourcing energy through a different mechanism such as balancing. In our view this is consistent with the scheme operating effectively.

Further, Synergy does not consider the success of the standard products should be measured solely by their uptake.

In terms of the buy/sell spread it is again important to revisit why the spread was set at 25% initially and reduced to 20% from 1 January 2015.

When setting the spread the following factors were taken into account:

- The average buy/sell spreads in the short term energy market and the national electricity market futures market;
- Anticipated activity within the regime;
- Synergy’s risk exposure; and
- A judgement-based decision was made taking into account less liquid markets tend to have wider buy-sell spreads.

Looking at these factors Synergy does not consider there to be sufficient evidence to move from the current buy/sell spread. In fact, Synergy considers that reducing the buy/sell spread could introduce arbitrage opportunities and place undue risk on Synergy.

⁸ Refer:

https://www.finance.wa.gov.au/cms/uploadedFiles/Public_Utility_Office/Synergy_and_Verve_Energy_Merger/Standard_Product_Regime_Market_Participant_Briefing.pdf

⁹ 2014 Report to the Minister on the Effectiveness of the EGRC Scheme.

It should be noted that Synergy was, and still is, concerned with the attention being afforded on the NEM futures practices - the WEM is a different market and the circumstances in which parties participate is different.

Finally, Synergy urges the ERA to exercise caution if it is considering reducing the buy/sell spread. Recognising the potential for a carbon trading mechanism in the future the ERA needs to be aware of the impact a carbon impost has on a buy/sell spread. In essence, where there is the requirement to include a carbon price, the real buy-sell spreads are significantly lower than the spreads prescribed in the Electricity (Standard Products) Wholesale Arrangements 2014. As such, Synergy notes that any future adjustment of the prescribed spread should be considered cognisant of the impacts of any future carbon regime.

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