



Economic Regulation Authority

Offer construction guideline and trading conduct guideline

Draft report

21 June 2023

Economic Regulation Authority

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Invitation to make submissions

Submissions are due by 4:00 pm WST, 18 July 2023

The ERA invites comment on this paper and encourages all interested parties to provide comment on the matters discussed in this paper and any other issues or concerns not already raised in this paper.

We would prefer to receive your comments via our online submission form <https://www.erawa.com.au/consultation>

You can also send comments through:

Email: publicsubmissions@erawa.com.au

Post: Level 4, Albert Facey House, 469 Wellington Street, Perth WA 6000

Please note that submissions provided electronically do not need to be provided separately in hard copy.

All submissions will be made available on our website unless arrangements are made in advance between the author and the ERA. This is because it is preferable that all submissions be publicly available to facilitate an informed and transparent consultative process. Parties wishing to submit confidential information are requested to contact us at info@erawa.com.au.

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1. Introduction

The Wholesale Electricity Market (WEM) in the Western Australian South-West Interconnected System operates under the *Electricity Industry Act 2004*, Electricity Industry (Wholesale Electricity Market) Regulations 2004 and Wholesale Electricity Market Rules (WEM Rules).^{1,2,3}

The Economic Regulation Authority is responsible for monitoring and enforcing compliance with the WEM Rules. In undertaking its functions, the ERA aims to provide businesses and consumers with confidence that the WEM operates efficiently and effectively.⁴ This document outlines the two draft guidelines developed by the ERA to assist market participants to understand and comply with the general trading obligations.

All market participants must comply with the general trading obligations from the commencement of the new WEM in October 2023.⁵ These obligations require participants to:

- Offer prices that reflect only the costs that a market participant without market power would include in a profit-maximising price offer (clause 2.16A.1).
- Avoid conduct that is false, dishonest, or has the purpose or the effect of distorting or manipulating prices in the WEM (clause 2.16A.3).

The general trading obligations prohibit conduct likely to undermine competition in the WEM and increase the cost of electricity for end consumers.

The ERA's draft offer construction guideline and draft trading conduct guideline are intended to provide regulatory guidance on these obligations for all participants in the short-term energy market (STEM) and real-time market (RTM), which includes the frequency co-optimised essential system services (FCESS) markets. The guidelines contain simplified examples to illustrate the behaviour expected of different facility types, including co-located and hybrid electric storage resources.

The ERA first consulted on its draft offer construction guideline from 23 December 2022 to 17 February 2023. The main issues raised by stakeholders on the ERA's draft guideline are summarised in Appendix 1.

The ERA may amend the guidelines when it considers necessary. For example, the ERA may choose to update the guidelines after responding to a request for guidance from a market participant.⁶ When considering the need for amendment to the guidelines, the ERA will work productively with WEM stakeholders and consider the views of market participants.

¹ *Electricity Industry Act 2004* (WA), ([online](#)).

² *Electricity Industry (Wholesale Electricity Market) Regulations 2004* (WA), ([online](#)).

³ Wholesale Electricity Market Rules (WA), 29 April 2023, ([online](#)).

⁴ Economic Regulation Authority. Statement of Strategic Intent, 2023-2025 ([online](#)).

⁵ Clause 2.16A in the 29 April 2023 Consolidated Companion version of the WEM Rules, which is the WEM Rules intended to be in force from commencement of the new market. ([online](#)).

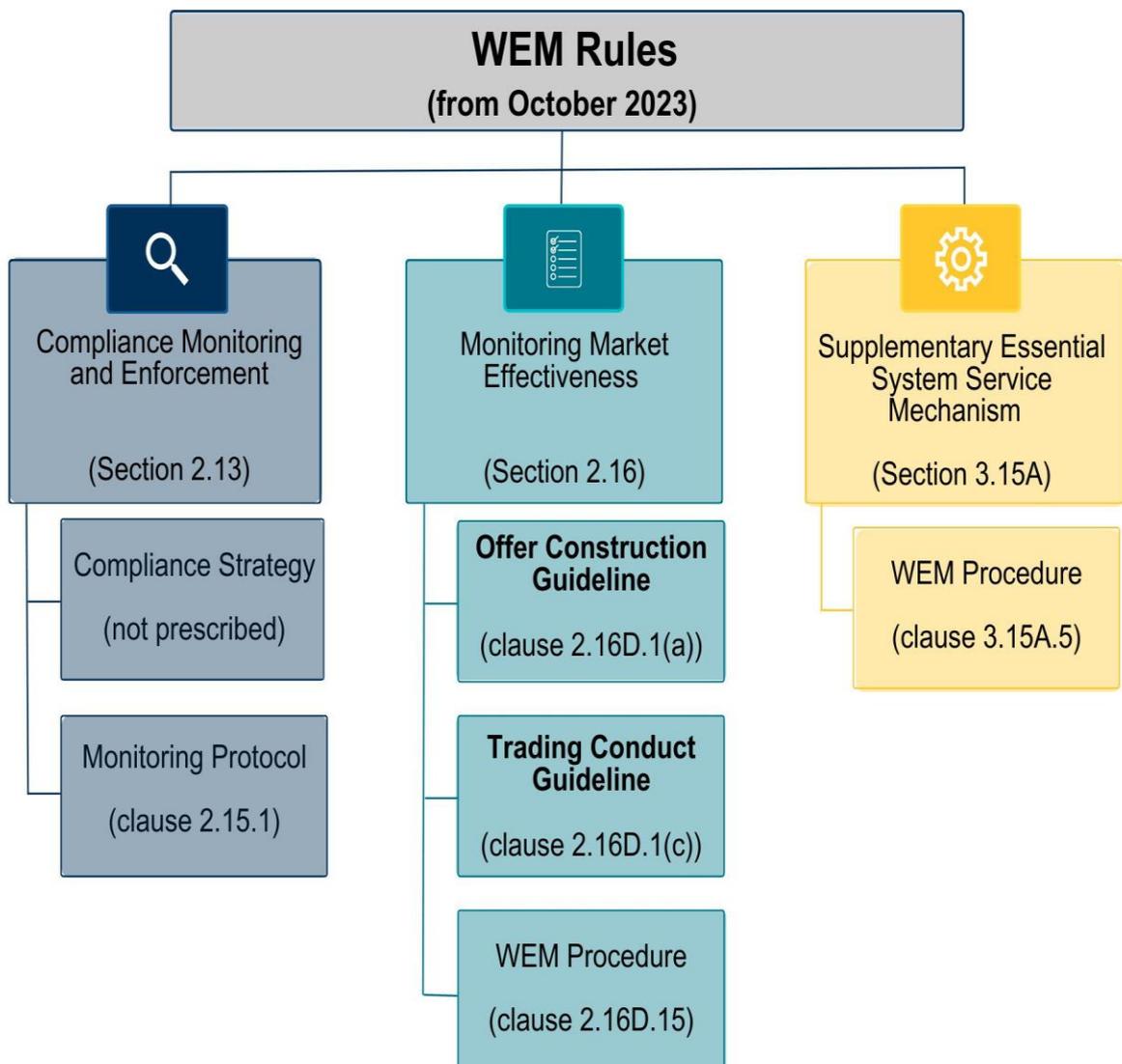
⁶ Under clause 2.16D.7 market participants may request offer construction guidance from the ERA ([online](#)).

2. Regulatory guidance

In addition to the two draft guidelines, the ERA is developing other regulatory guidance documents to assist stakeholders to understand and comply with their obligations in the new WEM (see [Figure 1](#)). Before new market start, the ERA will seek stakeholder feedback on three WEM Procedures, the:

- Portfolio Determination WEM Procedure [clause 2.16D.15].
- ERA triggering the Supplementary Essential System Service Mechanism (SESSM) WEM Procedure [clause 3.15A.5].
- Updated Monitoring Protocol WEM Procedure [clause 2.15.1].

Figure 1: The ERA's regulatory guidance documents⁷



⁷ The ERA's compliance strategy set out its approach to monitoring and enforcing compliance but is not prescribed by the WEM Rules ([online](#)). The document will be revised for the new WEM.

2.1 Compliance monitoring and enforcement

The ERA has a broad function to monitor the market for compliance with the WEM Rules and to investigate behaviour if it considers the behaviour has resulted in the market not functioning effectively (clause 2.13.2).

The two draft guidelines inform participants of the types of conduct and indicators of non-compliance the ERA will be monitoring regarding the general trading obligations. Maintaining adequate records will assist market participants to demonstrate to the ERA that their conduct was consistent with the general trading obligations [clauses 2.16A.1 or 2.16A.3].

The ERA's Monitoring Protocol WEM Procedure sets out how the ERA will monitor, investigate and enforce compliance.⁸ The ERA will consult on and implement changes to this WEM Procedure before new market start in October 2023. ERA will conduct any investigation of a breach of the general trading obligations in accordance with the Monitoring Protocol WEM Procedure.

⁸ Economic Regulation Authority, July 2020, Monitoring Protocol WEM Procedure ([online](#)).

3. Offer construction guideline

In the new WEM, a market participant must offer prices that reflect only the costs a participant without market power would include in forming profit-maximising price offers [clause 2.16A.1]. To assess compliance with this clause, the ERA will identify irregular price offers, that is, where a price offered by a market participant in its [Clause 2.16C.6 (c) and (d)]:

- Portfolio supply curve was inconsistent with the price that a market participant without market power would offer in a profit-maximising portfolio supply curve; or
- RTM submission was inconsistent with the price that a profit-maximising market participant without market power would offer in a RTM submission.

The new WEM Rules require the ERA to monitor the offers of participants with facilities in a material portfolio or a material constrained portfolio. The ERA's process for identifying these portfolios will be set out in a WEM Procedure [clause 2.16D.15]. In addition, offers from a market participant that were not being monitored as a material portfolio or a material constrained portfolio may be investigated for a breach of clause 2.16A.1 [clause 2.16C.11].

A market participant may only be found to be in breach of clause 2.16A.1 if the ERA determines the participant had market power when it made the offers [clause 2.16A.2]. The ERA must also determine that the irregular price offer has resulted in an inefficient market outcome [clause 2.16C.5].

The ERA must produce an offer construction guideline that [clause 2.16D.1(a)]:

- i. Provides guidance to market participants in relation to the price offer obligations under clause 2.16A.1;
- ii. Details how the Economic Regulation Authority will assess prices offered under clause 2.16C.6;
- iii. Permits the recovery of all efficient variable costs of producing the relevant electricity, including all costs incurred under long-term take-or-pay fuel contracts;
- iv. Outlines how the Economic Regulation Authority will consider price offers for different Facility types, including Electric Storage Resources;
- v. Provides examples illustrating the types of conduct that the Economic Regulation Authority considers would be likely to contravene the price offer obligations under clause 2.16A.1; and
- vi. Provides guidance to market participants on how the Economic Regulation Authority will assess inefficient market outcomes under clause 2.16C.7.

The ERA is interested in feedback from market participants on the updated draft offer construction guideline.⁹

3.1 Updates to the draft offer construction guideline

Substantial changes have been made to the draft offer construction guideline published in December 2023. In updating the guideline, the ERA has considered how offer construction

⁹ Economic Regulation Authority, 2023, draft offer construction guideline ([online](#)).

affects pricing outcomes for electricity consumers and has provided more detailed guidance to assist market participants. The draft guideline has been updated to incorporate:

- Stakeholder feedback to the ERA in February 2023 (summarised in appendix 1).
- Stakeholder feedback on exposure drafts of the WEM Rules.¹⁰
- The WEM Rules gazetted on 31 March 2023.¹¹
- Guidance on essential system services offer construction.
- Additional examples of offer construction.

Stakeholders sought clarity on including a risk margin or premium and compliance costs in offer construction. The updated draft offer construction guideline clarifies that including these costs in offer construction is inconsistent with the WEM Rules.

Market offers based on expected costs may result in under or over recovery of costs in each dispatch interval. However, a profit maximising market participant without market power would not include a risk premium in offers because it would expect to recover its costs over time without the inclusion of a risk premium. With the inclusion of a risk premium a market participant would risk lower profits.

Compliance costs do not change with the production of energy or FCESS and may not be included in offer construction. For example, generators who are rarely dispatched in the RTM incur compliance costs to keep records and have good governance procedures. If these generators relied on recovering compliance costs through offers, they risk not recovering their costs when they are not dispatched.

There are other elements in the design of the market that may allow for the recovery of costs associated with compliance with the WEM Rules. The reserve capacity mechanism and the calculation of the benchmark reserve capacity price may consider how market participants recover these costs. Costs associated with breaching the WEM Rules may not be recovered through offers to the market.

¹⁰ Energy Policy WA, April 2023. Response to stakeholder submissions ([online](#)).

¹¹ WEM Amendment (Tranche 6a) Rules 2023, 31 March 2023 ([online](#)).

4. Trading conduct guideline

The ERA has drafted a trading conduct guideline for consultation.¹²

The trading conduct guideline is intended to provide:

- Clarity and guidance to market participants regarding the prohibited conduct described in clause 2.16A.3.
- Examples illustrating the types of conduct that the ERA considers would be likely to contravene clause 2.16A.3 (clause 2.16D.1(b)).

Clause 2.16A.3 broadly prohibits making ‘bad faith’ submissions to the STEM and RTM, which includes conduct that is false, misleading, or likely to mislead, or has the effect of distorting or manipulating prices in the market.

The ERA is interested to hear from stakeholders on suitability of the guidance provided in this document.

¹² Economic Regulation Authority, 2023, draft trading conduct guideline ([online](#)).

5. Consultation

The ERA is seeking feedback from market participants and other interested stakeholders on the draft offer construction guideline and draft trading conduct guideline. The submission period will be open for four weeks. The ERA will publish all submissions and its response to the issues raised during consultation. The ERA may redact any information in a submission that it considers to be confidential.

The ERA expects to publish the outcome of this consultation and the updated offer construction guideline and trading conduct guideline prior to new market start in October 2023.

Stakeholders are invited to comment on any aspect of the guideline and provide responses to the following consultation questions:

5.1 Draft offer construction guideline questions

1. What additional information, if any, do you think would be useful to assist market participants to inform their offer construction?
2. What other costs do you consider valid to include in the efficient cost for a generator, electric storage resource or other facility type?
3. What other offer construction examples would be useful to include in the guideline?
4. Electricity markets around the world are learning how electric storage resources can participate. What specific questions do you have on how offer construction by these resources will be viewed by the ERA?
5. Does the guideline provide sufficient clarity on the records that the ERA considers are necessary for a participant to comply with its obligations in the WEM Rules? If not, what additional information would stakeholders find useful to include in the guideline?

5.2 Draft trading conduct guideline questions

6. What additional information, if any, do you think would be useful to help market participants avoid conduct prohibited by the trading conduct obligations?
7. What other conduct examples would you find useful to include in the guideline?

Appendix 1 Issues raised in submissions

The ERA received seven written submissions on the draft Offer construction guideline in February 2023. Each submission is published on the ERA's website.¹³ This table summarises the issues raised by stakeholders and the ERA's response to each issue.

Issue	Stakeholder views	ERA response
Long-term take or pay (LTTOP) contracts for fuel	Requested clarity on whether the clause allows for recovery of all \$/GJ costs incurred under a LTTOP contract OR only costs under such contracts that are variable.	Rule 2.16D.1(a)(iii) of the updated WEM Rules specifically allows for the recovery of the cost incurred under such contracts. The offer construction guideline has been updated to include this aspect of the WEM Rules.
Risk Margin	Participants expect to include risk margins in STEM and RTM offers.	The ERA understands that all market participants must make forecasts and that these forecasts will not be accurate for every Dispatch Interval or when considered over short periods of time. However, a prudent market participant without market power that seeks maximising its profits would improve its forecasting methods so that over medium to long term it will not incur consistent gains or losses due to forecasting errors. Such a market participant improves its forecasting method to ensure unbiased forecasts – forecasts that on average produce accurate results.
Opportunity Cost of Real-Time Market (RTM) returns in STEM offers	In their STEM offers, generators should be permitted to include the opportunity cost of selling capacity in the RTM.	The STEM is a financial market for market participants to trade around their bilateral positions rather than for energy dispatch in the real-time-market, so a market participant without market power would offer their portfolio's capacity into the STEM in the Trading Interval based on its expectation of the real-time-market for energy price.

¹³ ERA 2023, Monitoring the new WEM ([online](#)).

Issue	Stakeholder views	ERA response
Ex-ante vs Ex-post Offers and Monitoring (examples used in the guideline)	The draft guideline contains examples of offers ex-post. As generators need to construct offers from an ex-ante perspective, additional examples from an ex-ante perspective would be useful.	Additional examples have been added to assist market participants.
Offers below Cost	Participants identified circumstances where offers into the STEM and RTM may be below cost, for example to avoid shutting down and remaining available for upcoming higher priced periods.	Market participants may make price-quantity pair offers below the efficient variable cost of those offers. These offers may be consistent with clause 2.16A.1 of the WEM Rules, as long as: <ul style="list-style-type: none"> • The Market Participant can demonstrate the reasoning for their pricing strategy and, for example, how it is linked to some operating or non-operating aspect of the market participant's facilities; and • The pricing strategy is consistent with Clause 2.16A.3 which prohibits conduct that has the purpose of manipulating prices in the WEM.

Contract terms	<p>Generators asked to include the restrictions from long-term supply contracts as a cost in their offers. Renewable generators can often only gain finance through these contracts.</p>	<p>Renewable generators may enter contracts to sell their energy and/or large-scale generation certificates (LGC) at agreed prices under such contracts. The guideline clarifies that constructing price offers must be based on the opportunity cost of producing energy (or the relevant service). For example, a wind farm receives one LGC for each MWh of electricity generation. The construction of a Price-Quantity pair offer for generating electricity must value the associated LGC at the prevailing market price for LGC, rather than agreed prices on bilateral contracts. This is because the generator can procure LGCs from the market at the prevailing market prices.</p> <p>Similarly, a wind farm that has previously sold its energy forward to third parties at agreed prices must not use such contract prices as the basis for the construction of price offers. The opportunity cost of producing electricity for the wind farm is any cost it incurs to generate electricity (for example, VOM and opportunity cost related to LGCs). The wind farm offers to the market based on the opportunity cost of generating electricity and receives prevailing market prices, as is expected from a profit-maximising market participant without market power.</p> <p>The wind farm operator can meet its contractual obligations by paying prevailing energy market prices to acquire energy and deliver/satisfy its contractual quantities.</p> <p>The incremental cost of generation for the wind farm is based on VOM and LGC opportunity cost (or any other costs) regardless of its contract prices, as explained in the table below:</p> <table border="1" data-bbox="842 991 1933 1342"> <thead> <tr> <th></th> <th colspan="2">Energy market</th> <th colspan="2">Contract</th> <th></th> </tr> <tr> <th>Cash flow</th> <th>Pay</th> <th>Receive</th> <th>Pay</th> <th>Receive</th> <th>Net</th> </tr> </thead> <tbody> <tr> <td>A.Generation</td> <td>$VOM + other\ costs - LGC$</td> <td>P_e</td> <td>P_e</td> <td>P_c</td> <td>$P_c - (VOM + other\ costs - LGC)$</td> </tr> </tbody> </table>		Energy market		Contract			Cash flow	Pay	Receive	Pay	Receive	Net	A.Generation	$VOM + other\ costs - LGC$	P_e	P_e	P_c	$P_c - (VOM + other\ costs - LGC)$
	Energy market		Contract																	
Cash flow	Pay	Receive	Pay	Receive	Net															
A.Generation	$VOM + other\ costs - LGC$	P_e	P_e	P_c	$P_c - (VOM + other\ costs - LGC)$															

Issue	Stakeholder views	ERA response					
		B.No-generation	0	0	P_e	P_c	$P_c - P_e$
		Incremental cost and benefit of generation (A-B)	<p>Generator incurs $VOM + other\ costs - LGC$ and receives P_e.</p> <ul style="list-style-type: none"> P_e denotes energy market price and P_c denotes contract price. 				
		<p>The efficient variable costs that a market participant without market power would incur in producing electricity does not include costs incurred under arrangements that do not reflect a bona fide commercial bargain between the parties, such as related party transactions that are not on arm's length terms.</p> <p>For example, offers below cost of supply must ensure consistency with clause 2.16A.3. Such offers must not be for the purpose of distorting or manipulating prices in the WEM.</p>					

Issue	Stakeholder views	ERA response
Record keeping	Participants questioned the need for retaining and providing to the ERA some records concerning internal governance arrangements.	<p>The list of records and reasoning for keeping the records has been updated in the guideline. The updated draft guideline clarifies that only board and board committee discussions regarding compliance with the general trading obligations are required.</p> <p>Compliance with the general trading obligations is a significant regulatory and governance issue and it is important that the entity's Board is aware of the market participant's activities.</p> <p>Clause 2.16A.8 of the WEM Rules specifies that a market participant must "adduce evidence that it had reasonable grounds" for its WEM submissions, so keeping records and evidence of oversight at board level will be helpful for a market participant.</p> <p>Energy Policy WA's (EPWA's) statement in response to submissions on draft MPM amending WEM Rules is that "... EPWA expects that those market participants able to exercise market power should already have all necessary systems and processes to comply with their obligations, including record keeping obligations."</p>
Designating costs as fixed or variable	For example, are fuel transport costs fixed or variable costs?	The updated draft guideline clarifies the nature of fixed and variable costs related to fuel transport charges. Transactions for sourcing fuel, including short- or long-term contracts for fuel, take numerous forms. The guideline now outlines the circumstances when transport charges such as 'reservation charges' for gas pipelines – as determined based on spot market for pipeline capacity or short-term bilateral agreements for gas supply – can be included in price offers. The guideline also explains other circumstances where the inclusion of 'reservation charges' under fuel contracts may not be consistent with the WEM Rules. Market Participants are encouraged to seek guidance from the ERA about the inclusion of transport charges.

Issue	Stakeholder views	ERA response
Defining 'other costs'	<p>For example, payments to AEMO for essential system services and compliance costs.</p> <p>A stakeholder noted that compliance costs do not change in output and should be recovered through the reserve capacity mechanism.</p>	<p>The updated draft guideline contains several new cost classifications to address this issue. There is still an "other cost" category to allow for market participants to make a case that there are costs that the ERA is not aware of.</p> <p>As compliance costs do not change with the production of energy or FCESS, market participants may not include compliance costs in offer construction.</p>
Essential system services	Stakeholders requested guidance on offer construction for Frequency Control Essential System Services (FCESS).	Guidance and examples have been added to the updated draft guideline to address FCESS offer construction.