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Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
PERTH WA 6000

By email to: publicsubmissions@erawa.com.au

ERA CONSULTATION: OFFER CONSTRUCTION GUIDELINE AND TRADING CONDUCT GUIDELINE

Synergy welcomes the opportunity to provide a submission to the Economic Regulation Authority (**ERA**) on its further proposed amendments to the Offer Construction Guideline (**OGC**) and the Trading Conduct Guideline (**TCG**), which the ERA released for consultation on 5 November 2024[1] (**Second Consultation**).

Synergy understands that the ERA's further proposed amendments to the OCG and TCG have been made in response to submissions made to the ERA during the ERA's consultation in September 2024 on its first set of proposed amendments to the OCG and TCG[2] (**Original Proposed Amendments**), in addition to aligning the OCG and TCG with the *Wholesale Electricity Market Amendment (FCESS Cost Review) Rules 2024* (**FCESS Rules**) approved by the Minister on 29 October 2024. The FCESS Rules implement amendments to the Wholesale Electricity Market Rules (**WEM Rules**).

Synergy thanks the ERA on its revised proposed amendments to the OGC and TCG as outlined in the Second Consultation in response to submissions received on the Original Proposed Amendments. Synergy supports the ERA's proposal to reinstate the existing treatment of the Contingency Reserve Raise runway costs as a valid component in energy offers and its consideration that the matter requires comprehensive assessment.

Synergy sets out below the key issues that it considers have not been addressed in the Second Consultation and must be addressed before the ERA finalises the OCG and TCG.

1. Offer Construction Guideline

a. Multiple Fuel Supply Contracts Including Long-Term Take-or-Pay Fuel Contracts

In Synergy's submission[3] to the Original Proposed Amendments (**Synergy Original Submission**), Synergy raised fundamental concerns that the OCG does not provide guidance to Market Participants with multiple fuel supply contracts, including long-term take-or-pay (**LTTOP**) fuel contracts, as to how to compliantly determine fuel input prices and price offers in certain circumstances.

[1] As published on the ERA's website.
[2] Released 5 September 2024, and published on the ERA's website.
[3] Refer to Page 9, item 5, of the Synergy – offer construction guideline and trading conduct guideline.

The ERA's Second Draft Report[4] contains responses to the feedback received on the Original Proposed Amendments. The ERA's response to Synergy's concern as raised in the Synergy Original Submission is:

> *"The OCG expressly addresses this question. The ERA notes that the OCG can only provide general guidance."* [5]

Synergy understands the ERA is referring to section 3.2.1.2 of the OCG, which relevantly states:

> *"…the Market Participant **must not average the prices payable under those fuel contracts** for use as a single fuel cost for that period in a set of Price-Quantity Pairs.*
>
> *If a Market Participant has a LTTOP fuel contract that is out-of-the-money, it may use the LTTOP contract price to form its offers (as if the unit fuel price applicable to the take-or-pay volumes is the incremental fuel cost) if the volume of fuel used over the relevant period remains below the LTTOP contract quantity (for example TJ/day, TJ/month or TJ/year). Where, for a LTTOP contract quantity, constraints apply for different time periods (for example, when both daily and monthly off-take quantity constraints apply), the Market Participant may use the out-of-the-money contract price as long the volume of gas used remains below the quantity constraints applicable to that period.*
>
> *A Market Participant may allocate fuel between generators and Dispatch Intervals flexibly within the constraints of its contracts. Once the Market Participant exceeds it LTTOP contract volume it must revert to its new cost of fuel (for example, the prevailing market price).*
>
> *The allocation of costs across time and resources must also be compliant with the Trading Conduct Guidelines. For example, Market Participants must not use the method to manipulate market prices, which may be a breach of WEM Rule 2.16A.3."* [6]

Specifically, Synergy considers that the approach outlined in the OCG for how LTTOP fuel contracts can be accounted for in offer prices may not allow for the recovery of all LTTOP fuel contract costs in credible scenarios. Therefore, Synergy considers that the position in the OCG is inconsistent with the requirements set out in clause 2.16D.1(a)(iii) of the WEM Rules.

Synergy understands the ERA's reference to the OCG only being able to provide "*general guidance*" means the ERA considers Synergy can request specific guidance under the process in clauses 2.16D.5 to 2.16D.14 of the WEM Rules. Synergy intends to request such specific guidance.

b. *Long-Term Service Agreements*

Synergy understands the OCG:

[4] Refer to Second Draft Report.
[5] Refer to Page 13 of Appendix 4 of the Second Draft Report.
[6] Refer to Pages 25 to 26 of the OCG in Second Consultation

1. effectively prohibits Market Participants from including any costs from any long-term service agreements in their Real-Time Market Submissions if the payments for services provided under those contracts are not structured as variable payments (on the basis that such contracts are 'fixed costs'); and

2. allows for the recovery of service agreement costs if payments for services under those contracts are structed as variable payments (e.g. paid based on the number of operating hours etc.).

Synergy notes that fixed price service agreements are the normal approach to service contracts within the electricity industry. Further, Synergy considers entering variable cost service agreements will almost certainly result in higher overall costs for the same level of services (e.g. as service providers seek to shield themselves from the risk the output of the Facility is lower than forecast).

Synergy disagrees with the ERA's prohibition on including costs associated with fixed price service agreements as an allowable component in Market Participant's offer price construction. Synergy considers that this proposal will have the perverse outcome of incentivising Market Participants to enter into variable cost service agreements (at a higher overall cost to the Market Participant) to enable these costs to be included in the construction of offer prices. This will ultimately translate into higher costs for consumers.

Synergy contends that the exclusion of fixed price service agreements is an "*inefficient market outcome*" and is inconsistent with the market objectives. Synergy requests that the ERA take a pragmatic view of allowing the inclusion of such costs in a similar manner to the inclusion of start-up costs. For example, by allowing the fixed costs to be 'smeared' and unbiasedly allocated to a Facility's expected output.

Synergy considers such costs are an allowable component of a Market Participant's offer prices under the WEM Rules because:

3. their inclusion does not result in an "*inefficient market outcome*"; and/or

4. the contract duration of service agreements are generally shorter than the expected life of a Facility, therefore, service agreement costs should be considered as 'variable' costs in the context of the capital costs being 'fixed'.

c. *Asymmetrical Risk*

In the Synergy Original Submission, Synergy requested the ERA reconsider its prohibition in the OCG against Market Participants including a risk margin in their construction of offers. Synergy noted that, without the allowance for such risk margins, Market Participants would not be able to recover all their efficient variable costs in circumstances where there are asymmetrical risks.

In its Second Draft Report, the ERA relevantly stated:

> *"No example has been provided to support the existence of asymmetric risks faced by Market Participants."* [7]

[7] Refer to Page 2 of Appendix 4 of the Second Draft Report.

Synergy notes that there are many well-known asymmetrical risks in electricity markets, particularly in relation to electricity generation. For example, such asymmetrical risks include:

1. Non-symmetrical and 'lumpy' concentrations of offer prices between the Energy Offer Price Floor and Energy Offer Price Ceiling, which are further compounded by factors such as transmission constraints and FCESS trade-offs. For example, unit commitment next to a 'step' reduction in offer prices can lead to large losses if load is lower than forecast, but only small increases in profit if load is higher than forecast.

2. The allocation of FCESS costs to Facilities can be non-symmetrical, particularly for services which allocate these costs on the basis of a 'runway' methodology. Both the total market FCESS costs (including FCESS uplift costs), and the share of these costs allocated to the Facility are not known at the time of the offer construction. Further, for larger Facilities these costs often rise non-symmetrically with increasing Facility output.

3. For Facilities with emerging asset constraints or issues, the asset repair costs and Capacity Cost Refunds present a significant non-symmetrical risk. If an elevated, credible risk of a possibly catastrophic outage has been identified should the Facility's output occur at a particular level, or in some cases any level, the risk of operating is very asymmetrical because the Facility will either receive the Market Clearing Price(s) for energy and any services it provides, or it will experience a very costly outage.

   For example, assume:

   i. a Facility faces a five percent chance of experiencing a catastrophic outage if it continues to operate; and

   ii. AEMO is unable to schedule an outage for the Facility that would have allowed for it to be checked or repaired (such preventative repairs being for a lesser amount than the repair costs for the catastrophic outage).

   The Facility will either:

   iii. incur a Forced Outage, which could result in very large costs, including lost energy and FCESS revenues, repair costs and capacity refund costs; or

   iv. Continue to operate for small benefits of providing energy and FCESS to the market.

   An alternate example is where a risk is identified that if a Facility de-commits, it may have a five percent chance of not being able to re-synchronise and requiring significant repairs. In this case the out-of-merit operation may be favourable to the risks associated with cycling the Facility, even when this cost may be greater than the notional start-up cost of the Facility.

Further, it is likely that at the time of offer construction the actual cost cannot be quantified, but significant non-symmetrical risk may be known.

2. Trading Conduct Guideline and Offer Construction Guideline

a. *Offers At or Below EVC and Inefficient Market Outcomes*

In the Synergy Original Submission, Synergy requested the ERA to confirm whether the ERA's view was that the only circumstances where pricing offers below Efficient Variable Costs (**EVC**) is a breach of the WEM Rules is when that pricing relates to predatory pricing. Synergy also requested clarity and guidance on what constitutes "*inefficient market outcomes*".

In its Second Draft Report, the ERA relevantly stated:

> *"The ERA has included an additional example (Example 11) in the Trading Conduct Guideline to provide guidance on behaviour that may distort market prices."* [8]

> *"The ERA considers that Example 25* [in the OCG] *provides sufficient guidance on what constitutes 'inefficient market outcomes."* [9]

Synergy notes the following about the examples the ERA has referred to:

1. Example 11 in the TCG is an example of a scenario where the ERA considers below-cost offers amount to predatory pricing.

2. Example 25 in the OCG is an example of where the ERA considers 'economic withholding' of capacity has resulted in "*inefficient market outcomes*".

Synergy considers that neither of these examples completely responds to the issues raised in the Synergy Original Submission, including because the ERA has not confirmed:

3. whether the ERA considers there are any circumstances, other than predatory pricing, where a Market Participant pricing offers below EVC can be a breach of the WEM Rules; nor

4. what types of outcomes the ERA considers meet the definition of an "*inefficient market outcome*". For instance, Example 25 in section 7 of the OCG sets out a modelling process the ERA 'may' follow to determine whether Irregular Price Offers have resulted in "*inefficient market outcomes*". However, this section does not state what types of outcomes from the modelling would generally trigger the ERA's determination that an outcome is an "*inefficient market outcome*". Is the ERA saying that any outcome that is even $0.01 different to the counterfactual modelled by the ERA is an "*inefficient market outcome*"? Further, noting that the OCG states that the ERA 'may' use such

[8] Refer to Page 18 of Appendix 4 of the Second Draft Report.
[9] Refer to Page 12 of Appendix 4 of the Second Draft Report.

a modelling approach, Market Participants require clarity and guidance on what other approaches the ERA 'may' use.

Therefore, Synergy repeats its request that, as required by clauses 2.16D.1(a)(vi) and 2.16D.1(b) of the WEM Rules, the ERA please provide clarity and guidance on the boundaries of when pricing below EVC is compliant and when it is non-compliant with the WEM Rules.

Synergy has also requested the ERA provide clarity, guidance, and examples about whether there are any scenarios where pricing above EVC may be consistent with the WEM Rules (e.g., because the outcome of such pricing is not an "*inefficient market outcome*" under the WEM Rules).

Under the WEM Rules that applied prior to 20 November 2024 (i.e., before the commencement of the FCESS Rules), such above-EVC pricing was arguably compliant when the offer prices were consistent with the prices a Market Participant without market power would offer.

However, under the FCESS Rules and the ERA's proposed amended OCG, Market Participants are now left with no clarity or guidance on how to construct offers in circumstances where the cost to generate is not the only relevant factor in a decision regarding whether to generate or not generate, such as in Example 'c)' in the 'Asymmetrical Risk' section above.

Synergy considers the following examples should be included in the TCG:

Offer pricing at or below EVC is compliant when it is required to:

a. effect dispatch that reflects physical limitations of the Facility (e.g., to ensure a Facility is not required to be dispatched below its minimum stable generation level or to reflect instances where a Facility is physically required to hold at a particular level during its ramp up or ramp down processes); and

b. avoid risk of Forced Outages in circumstances where the Facility is being operated in a certain manner that increases the risk of Forced Outages.

3. Trading Conduct Guideline

a. 'Distortion' of Market Prices

In the Synergy Original Submission, Synergy requested the ERA provide 'clarity and guidance' on the baseline against which 'distortion of market prices' is to be measured.

In its Second Draft Report, the ERA relevantly stated:

> *"The ERA has included an additional example (Example 11) in the Trading Conduct Guideline to provide guidance on behaviour that may distort market prices."* [10]

Synergy does not consider Example 11 provides the clarity or guidance required by the WEM Rules about the baseline against which 'distortion' of market prices will generally be assessed.

[10] Refer to Page 18 of Appendix 4 of the Second Draft Report.

Synergy reiterates its view from the Synergy Original Submission that, because the WEM Rules that applied prior to 20 November 2024 (i.e., before the commencement of the FCESS Rules) required a Market Participant to offer at the price a Market Participant without market power would offer, the baseline against which such a distortion is measured was clear (i.e., the baseline was the price that would have resulted if the Market Participant had priced in the same manner as a Market Participant without market power). However, under the FCESS Rules, a Market Participant will be entitled to offer at or below EVC, unless, inter alia, this 'distorts' market prices. Consequently, the baseline against which such a distortion is measured is not clear.

Therefore, it is considered that under the FCESS Rules, there is a greater need for the ERA to provide clarity and guidance on the baseline it will measure such distortions against so that Market Participants can determine what conduct is prohibited under the WEM Rules and what conduct is compliant. Without such clarity and guidance, the TCG will not comply with requirements of clause 2.16D.1(b) of the WEM Rules, and Market Participants will not be able to know when their pricing conduct may be 'distorting' market prices and be in breach of clause 2.16A.3(c) of the WEM Rules.

b. *Offers below EVC for a Gentailer*

Synergy notes that a 'short' contract position may create a financial incentive for Market Participants to offer at below cost, resulting in inefficient outcomes for the market overall. Synergy considers that the TCG should provide guidance on these circumstances.

Simplified illustrative example:

Assumptions:

- The Energy Offer Price Floor is -$1,000, and this is "expected" to be the Reference Trading Price for the relevant Trading Interval;
- The cost incurred by the unit if it runs through for a single Trading Interval at the Energy Offer Price Floor is equal to its minimum stable generation (MW) x 0.5 Hours x Energy Offer Price Floor;
- The cost to cycle the unit for a single Trading Interval is equal to the Facility's start-up cost;
- The market consists of three identical Facilities (A, B and C), that have different contract position in the WEM as shown in the table below.

Facility	Start-up costs ($)	Minimum stable generation (MW)	Minimum down time (hours)	Contract position (MW)
A	50k	100	0.5	100
B	50k	100	0.5	0
C	50k	100	0.5	200

In the absence of a contract position all three Facilities should be indifferent to decommitting. By decommitting, the Facilities will incur $50k in start-up costs in a future Trading Interval but will withdraw energy that is worth -$50k from the market. However, their behaviour is likely to be highly impacted by the presence of a contract position.

Trading behaviour incentives:

i. Facility A, due to its fully hedged position, is unlikely to decommit for a single Trading Interval because:

- it is waiting to see if the other Facilities will reduce their output, which would prove more beneficial to Facility A than locking in its own cycling cost;
- cycling Facility A's unit increases its operational risk with minimal increase in its expected return;
- if there is uncertainty regarding whether the Energy Offer Price Floor will be hit in a single Trading Interval, decommitment will lock in a start-up cost of $50k. However, continuing to operate will have an opportunity cost of at most $50k (i.e. the "worst" possible outcome for Facility A in the market is $50k opportunity cost, but if the Energy Market Clearing Price were to end up at a higher price, Facility A's opportunity cost would be lower);
- if Facility A decommits, the Reference Trading Price may no longer reach the Energy Offer Price Floor, however Facility A will still incur start-up costs; and
- even if the Energy Offer Price Floor does eventuate and/or occurs for many Trading Intervals, if Facility A has a low risk appetite or a simplified trading strategy, Facility A may rationally choose to forgo any opportunity costs and choose to continue to run behind its contract position.

ii. Facility B however, fully dependent on the outcomes in the Real-Time Energy Market, is more likely to decommit if the Reference Trading Price is expected to be set at the Energy Offer Price Floor, particularly if energy prices in adjoining Trading Intervals are at or below Facility B's variable cost; and

iii. Facility C is over-contracted, therefore it may be incentivised to operate at the Energy Offer Price Floor irrespective of market price signals and its true decommitment costs because:

- it is waiting to see if other Facilities will reduce their output, which would prove more beneficial to Facility C than locking in its own cycling cost;
- cycling Facility C's unit increases its operational risk with minimal increase in its expected return;
- if there is uncertainty regarding whether the Energy Offer Price Floor will be hit in a single Trading Interval, decommitment will lock in a start-up cost of $50k. However, continuing to operate will have an opportunity cost of at most $50k;
- if Facility C decommits, the Reference Trading Price may no longer reach the Energy Offer Price Floor, however Facility C will still incur start-up costs;
- if Facility C decommits, the Reference Trading Price may no longer reach the Energy Offer Price Floor, reducing the benefit of Facility C's over-contracted supply position during negative priced Trading Intervals (i.e. negative cost);

- Facility C is likely to, unless required not to, increase output to ensure the Energy Offer Price is reached to maximise the expected benefit of its over-contracted supply position; and
- even if the Energy Offer Price Floor does eventuate and/or occurs for many Trading Intervals, if Facility C has a low-risk appetite or a simplified trading strategy, Facility C may rationally choose to forgo any opportunity costs and choose to continue to run behind its contract position.

Further to these points note that Facility B, to the extent that it finds itself even with a partial contract position relative to its minimum stable generation, would be more likely to operate like Facility A than to decommit.

The amended stance from the ERA to allow below cost offers presents significant implications for market outcomes and could negatively impact Market Participants with 'long' contract positions. Market Participants require further guidance from the ERA regarding when below cost offers are not acceptable beyond that contained in the current Example 11: Predatory pricing. Synergy also notes that negative price outcomes for the energy market have flow on cost impacts to the FCESS markets and increase the costs of FCESS Uplift Payments (and Energy Uplift Payments for RoCoF under the FCESS Rules).

c. *Guidance on RoCoF Offer Obligations*

Synergy supports the ERA's proposed amendment to the TCG to include an additional example (Example 8) under section 3.3. Synergy considers that the inclusion of Example 8 provides clarity to Market Participants on their offer obligations in relation to RoCoF control services under the FCESS Rules and the conduct expected under clause 2.16A.3 of the WEM Rules.

Synergy notes that it expects that there is an inverse relationship between the level of RoCoF service and Contingency Reserve Raise required in the WEM and considers that the Wholesale Electricity Market Dispatch Engine (**WEMDE**) may deliver circulatory outcomes as Market Participants respond to the various market signals for the delivery of FCESS services.

Synergy thanks the ERA for this submission opportunity.

Yours sincerely

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