

3 July 2017

Economic Regulation Authority
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PERTH BC WA 6849

By email: publicsubmissions@erawa.com.au

To whom it may concern,

2016 Review of the Effectiveness of EGRC Regulatory Scheme Discussion Paper

Kleenheat is grateful for the opportunity to make a submission to the ERA's review of the effectiveness of the operation of the EGRC Regulatory Scheme.

1. Effectiveness of EGRC Regulatory Scheme for Competition

Prices Offered by Synergy

Kleenheat would like the ERA to investigate the margins secured by Synergy in the sale of electricity from Synergy WBU to both Synergy RBU and the competitors of Synergy. Excessive margins are an indicator of the potential exploitation of market power. Kleenheat recommends that the ERA investigate if the pricing of Synergy includes an excessive risk premium and/or margin, particularly in future years.

Kleenheat would like the ERA, as part of its review, to investigate the non-price terms and conditions attached to retail offers to contestable customers, and to assess the commerciality of the retail offers from both a price and non-price perspective.

Generation Transparency

Kleenheat agrees with the ERA's assessment that there is too much discretion available to Synergy in determining the "relevant circumstances" applicable when offering wholesale supplies to retail or generation competitors. This has been mooted in past ERA reviews, while Market Participants are yet to have seen any changes to the transparency to define what relevant circumstances are, and when these have been applied.

Hindering Fair Competition

Further segmentation of Synergy's financial reporting is required to provide transparency of Synergy's results between contestable and non-contestable retail electricity segments, in order to provide confidence to Market Participants that the business is appropriately segmented and there is no cross subsidisation. Kleenheat recommends that the EGRC Regulatory Scheme is reformed to encompass more granular reporting of Synergy's profit performance in the contestable and non-contestable segments of the electricity market.

Facility Bidding of Synergy

Kleenheat believe an important requirement to improve transparency in the market is to require Synergy to adopt facility bidding. To provide further confidence to Market Participants, and in the lead up to facility bidding, Kleenheat suggests that, for at least 12 months prior to the commencement of facility bidding, Synergy be required to report its generation results by facility, to provide transparency on plant efficiency, availability and cost, and to enable other Market Participants to gain clarity on the likely dispatch profile and potential investment requirements in the market.

2. Stakeholder Feedback and Complaints on Effectiveness of EGRC Regulatory Scheme

Kleenheat supports the objective of the EGRC Regulatory Scheme, as defined by the ERA as “to mitigate the increased potential for exercising market power, which arises due to the merger of Synergy and Verve, by ensuring a level playing field for competitors and new entrants, in order the facilitate competition” and supports the need for this to be made more explicit under the scheme. In addition, the scheme could be further improved by defining what an even playing field looks like in order to be able to assess the scheme’s effectiveness. However, Kleenheat believes the existing Standard Products regimes must be reformed to achieve the objective of the EGRC Regulatory Scheme.

3. Standard Products

Kleenheat’s view is that the Standard Products regime is ineffective as either a price discovery tool (given the excessive buy/sell spread) or as a competitively priced option for procurement of wholesale energy, as evidenced by the very limited activity since commencement of the regime two years ago.

Kleenheat supports the ERA’s intention to develop an appropriate methodology for an optimal buy/sell spread in Standard Products. Kleenheat believes this can only be achieved by the redesign of the Standard Products regime.

Kleenheat believes the existing Standard Products regime has two fundamental flaws.

Firstly, Synergy is responsible to determine the price of the Standard Products but it has an inherent incentive to restrict access of its competitors to competitively priced access to wholesale supply. The theory of fair market value dictates the importance of a willing buyer and a willing seller. It is arguable that Synergy is not a willing seller based on the un-competitiveness of the pricing of Standard Products as evidenced by the absence of contracting through this mechanism. It is important to reinforce the criteria for any regulatory scheme is that it attempts as best it can to replicate the outcomes that would have been achieved if a fair and open market was to exist. The market power of Synergy is not adequately addressed by the current design of the Standard Products regime because the pricing of these products does not reflect fair market value.

The second flaw is that the Standard Products regime is poorly transparent. The methodology that underpins the Standard Products regime is opaque reinforcing the suspicion that its outcomes do not represent fair market value

To address these flaws, Kleenheat recommends the ERA investigate a 'Dutch Auction' as a fair market value framework to determine the optimal buy/sell spread. Kleenheat recommends that the design of the price formation process of the Standard Products should be based on a Dutch auction. A Dutch auction would entail Synergy being obliged to offer blocks of wholesale electricity to an auction whereby market participants will bid for these blocks of wholesale supply on a closed tender basis where multiple bids are permitted from single parties. By the nature of an auction of this type this would determine a fair market value for the Standard Product in contrast to the inflated, out of the money pricing of these products under the existing regime which has been proven not to be either fair or effective. This would result in a market based price determination process that would address the current problems of Synergy market power and inherent incentive not to price competitively. Kleenheat believes that the operation of the Dutch auction is the lowest cost, administratively simple and most effective means to determine a fair market price for Standard Products.

Kleenheat believes there is more than adequate competitive tension amongst existing and new retailers to ensure the price of Standard Products is fair to all including Synergy.

Synergy has historically proposed large scale investments in new renewable generation projects through a renewable energy fund. This would significantly exacerbate the already problematic level of concentration in the Wholesale Electricity Market. The operation of a Dutch auction is an effective means to address the current and potentially deteriorating extent of market power in the Wholesale Electricity Market.

The retail electricity market in the South West Interconnected System cannot achieve the same degree of competitiveness and dynamism as being evidenced in the retail gas market until such time as the electricity market has achieved similar access to competitive wholesale supply as occurs in the gas market. The failure to reform the Standard Products regime will be directly detrimental to the competitive outcomes available to customers.

Kleenheat would appreciate the opportunity to discuss these matters in more detail with the ERA and looks forward to a more effective EGRC Regulatory Scheme as a result of this review.

Yours sincerely,

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