18 July 2023

Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

Submitted via email by graham.pearson@energycouncil.com.au to publicsubmissions@erawa.com.au

Offer construction guideline: draft for consultation AND
Trading conduct guideline: draft for consultation

The Australian Energy Council (the "**AEC**") welcomes the opportunity to make a submission to the Economic Regulation Authority (the "**ERA**") on the *Offer construction guideline: draft for consultation* (the "**Offer Consultation Draft**")[1] and the *Trading conduct guideline: draft for consultation* (the "**Trading Consultation Draft**").[2]

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. Our members collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to millions of homes and businesses, and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035, and is part of the Australian Climate Roundtable promoting climate ambition.

The AEC makes the following comments in relation to **both** the Offer Consultation Draft and Trading Consultation draft:

Issue	Page number	AEC's comments
Transition period	N/A	The ERA indicated at its online stakeholder workshop on 30 June 2023 that it aimed to have the final Offer Construction Guideline and Trading Conduct Guideline completed one month prior to the start of the new market. The new market will present a range of challenges to Market Participants and many are still working to set up their internal systems. Market Participants will need time to adjust to the new requirements in the Offer Construction Guideline and Trading Conduct Guideline and update and implement their procedures to ensure compliance. The AEC considers that there must be flexibility as Market Participants adjust to new requirements, especially when they are finalised so close to the market start, and encourages the ERA to adopt an amnesty period.

[1] See Offer construction guideline: draft for consultation
[2] See Trading conduct guideline: draft for consultation

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

[redacted]
E info@energycouncil.com.au
W energycouncil.com.au

ABN 92 608 495 307

Issue	Page number	AEC's comments
		There is already a precedent for amnesty periods to be applied so that Market Participants can adjust to new requirements. For example, Energy Policy WA released the Monitoring and Compliance Framework in the Wholesale Electricity Market Information Paper ("**Information Paper**") in 2020 and proposed an amnesty period "*to enable participants to adjust and become familiar to the new WEM requirements without the threat of compliance action*".[3] The Information Paper also noted that a similar amnesty was introduced for the Balancing Market in 2012. The AEC encourages the ERA to formally implement an amnesty period to assist Market Participants with adjusting to the significant changes created by the Offer Construction Guideline and Trading Conduct Guideline. This amnesty period will help Market Participants to improve their compliance without the threat of immediate action.
Offer Consultation Draft: Section 5.2 – Below-cost offers Trading Consultation Draft: Section 3.3 – Distorting or manipulating prices	Page 32-33 Page 9	The Offer Consultation Draft and Trading Consultation Draft take an economic purist approach and assume that offers below cost are unusual because Market Participants would pursue recovering their costs to maximise profits. The documents also note that generators cannot offer below costs if it is likely to have the effect of distorting or manipulating prices. This theoretic approach fails to consider that generators have operational reasons for dispatching their facilities. During ramp periods, it may be optimal for a generator to bid at the floor price to ensure they are dispatched to ramp up for future higher-priced intervals. Alternatively, a generator may seek to ride through a few negative-price intervals and remain online rather than being forced to shut down for an extended period. The Offer Consultation Draft appears to limit this activity because minimum offers are 'capped' at avoided start-up costs which, in some cases, may not be sufficiently low enough. Restricting the ability to ride through and ramp up is likely to bring unintended consequences, including reduced availability and reliability, and not deliver any benefits for the market. While the Offer Consultation Draft says that "*additional guidance on complying with clause 2.16A is in the Trading Conduct Guideline*"[4], neither document provides any detail on how, or whether, Market Participants can bid below cost for operational reasons. The AEC strongly suggests that permissions for temporarily bidding below cost be broadened in the Offer Construction Guideline and Trading Conduct Guideline to allow for operational reasons.
Offer Consultation Draft: Section 6.4 – Wind and solar generators	Page 38	Section 6.4 of the Offer Consultation Draft notes that wind and solar generators have an opportunity cost related to a production-based subsidy because they are eligible for large-scale generation certificates ("**LGC**"). The Offer Consultation Draft then provides a simple example where a wind farm doesn't have a Power Purchase Agreement ("**PPA**") so its offer is the VOM cost minus the LGC opportunity cost. This example applies to a narrow set of circumstances and many stakeholders sought further guidance in their response to the *Offer*

[3] See p14, Monitoring and Compliance Framework in the Wholesale Electricity Market Information Paper
[4] See 33, Offer construction guideline: draft for consultation

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Issue	Page number	AEC's comments
		construction guideline: Draft report ("**Draft Report**") about how the ERA would consider other commercial arrangements that are common in the market.[5] However, the Offer Consultation Draft and the Trading Consultation Draft do not address how PPA and LGC contract positions should be accommodated in offers from renewable generators. Many renewable generators have an amount of capacity contracted with a PPA and some contract a volume of LGCs or location-specific LGCs. In all cases, these would be considered an opportunity cost for the generators and influence their bidding strategy. The AEC again asks the ERA to outline how renewable generators should construct their offers taking into account common PPA and LGC commercial arrangements.

The AEC makes the following comments in relation to the Offer Consultation Draft:

Issue	Page number	AEC's comments
Section 3 – Test of market power	Page 7	Section 3 of the Offer Consultation Draft says that the ability of a Market Participant to raise prices for as little as one interval will be sufficient to establish that the Market Participant has market power, regardless of whether it was profitable. The AEC considers that this theoretical economic approach is disproportionate, overly onerous and will discourage new investment. It is already going to be challenging enough for the market to address the increased demand for new generation. Indeed, AEMO's recent NCESS tender forecasts a shortfall of up to 830MW by 2024 subject to generator outages, while the SWIS Demand Assessment notes that over 50GW of new generation and storage capacity is required in the next 20 years.[6] Despite this, the ERA's *Triennial review of effectiveness of the WEM Discussion Paper* found that "*existing price signals do not provide an adequate commercial justification for investing in the new, low-emission generation and storage that would meet the WEM Objectives*."[7] The ERA went on to say: "*…Prices in the WEM will not be high enough to support revenue sufficiency for wind, solar and battery storage facilities as more solar, wind and storage facilities enter the WEM, and coal and gas generators exit the market … As a result, all generators in the WEM will face lower and lower prices, which do not allow them to recover their initial investment costs*."[8] The ERA rightly notes that existing participants are not earning sufficient revenue and modelling in Energy Policy WA's RCM

[5] See for example the AEC's submission on the Draft Report and Synergy's submission on the Draft Report and Collgar's submission on the Draft Report
[6] See p7, SWIS Demand Assessment
[7] See p2, Triennial review of the effectiveness of the Wholesale Electricity Market 2022 Discussion paper
[8] See p13 and 18, Triennial review of the effectiveness of the Wholesale Electricity Market 2022: Discussion paper

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Issue	Page number	AEC's comments
		Review paper supports this.[9] The AEC considers that the Offer Consultation Draft, as drafted, will compound this problem by preventing Market Participants from recovering reasonable costs from the energy markets. Any offer construction guideline will be unable to capture all the circumstances and costs that must be recovered in offers, or take into account how offers often serve an operational purpose (such allowing a facility to ride-through or ramp up). The prescriptive 'economic purist' approach adopted in the Offer Consultation Draft will result in uncertainty, complexity and costs for existing Market Participants and could force them into lower offers than optimal and contribute to the revenue sufficiency problem. The Offer Consultation Draft, in its current format, signals that any offers which appear to recover more than the ERA's theoretical view of a generator's short-run operational costs, even if it isn't profitable, can be considered "irregular" and trigger an investigation. This suggests to potential investors in marginal flexible technologies, which the SWIS requires, that they cannot make a margin on their electricity because if the ERA perceives that they have, they will be investigated and potentially drawn into a costly and protracted legal battle. This approach will dissuade investors from entering the market, exacerbate the forecast capacity shortfall and threaten the WEM Objectives. In light of the above issues, the AEC encourages the ERA to avoid a theoretical economic approach to determining offers and instead assess market participants' pricing conduct in the context of a real-world competitive market. The AEC considers that the market power mitigation framework and offer construction guideline need to allow facilities to recover their costs and a reasonable return on investment. In addition, the AEC again seeks confirmation that the Offer Construction Guideline will be regularly reviewed and opened for consultation so that Market Participants can provide input on all of the cost components that should be included in the guideline as the market evolves, the generation mix changes, revenue adequacy fluctuates, and the market power mitigation framework progresses.
Section 4.1 – Efficient variable costs	Page 8	The Offer Consultation Draft says "*a variable cost incurred by a Market Participant is efficient if … The technical parameters relied upon to estimate costs are correct and supported by expert advice*."[10] The AEC seeks guidance from the ERA on where the costs of obtaining the expert advice is recovered.
Section 4.3.2 – Pre-transport fuel-input-cost	Page 20	Example 6 in the Offer Consultation Draft describes a basic scenario where a gas generator pays a fixed price for every unit of fuel used on a daily basis. While this example is useful, the AEC notes that most fuel arrangements are often far more complex and usually involve multiple contracts with daily, monthly and yearly volumes. The AEC asks the ERA to provide more detailed guidance in the Offer Construction Guideline on how Market Participants should price fuel when the contracts use a mix of volume periods. Without more guidance, there is a risk that Market Participants and the ERA will determine very different values for the market price of fuel based on information available to each of them.

[9] See p124, Reserve Capacity Mechanism Review Information Paper (Stage 1) and Consultation Paper (Stage 2)
[10] See 8, Offer construction guideline: draft for consultation

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Issue	Page number	AEC's comments
Section 4.3.3 – Fuel transport		The Offer Consultation Draft includes a section on recovering fuel transport costs and says: "*…a generator that frequently produces a large amount of electricity and whose Price-Quantity Pair offers are mostly below the market price, may find it profitable to enter a long-term fuel transport contract with a reservation and a commodity charge. To maximise profit, offers from such generators will not include the fixed reservation charges as transport charges payable under the contract do not vary with the increase in plant output.* *In this case, the opportunity cost of using the pipeline capacity would also depend on the prevailing market price for pipeline capacity that, for example, may be determined based on prices cleared in the spot market for the pipeline capacity.*"[11] The AEC suggests that this statement creates uncertainty and more detailed guidance is required. In particular, is the ERA suggesting that Market Participants could use spot market prices despite having long-term contracts? If so, this may lead to adverse outcomes. Firstly, how do Market Participants deal with a situation where the spot price is lower than long-term contracts and they are out of the money? Secondly, this approach may encourage participants to avoid 'fixed' transport costs and enter into higher cost variable contracts because they can include these costs in their offers. While this would allow Market Participants to recover their costs, it also means higher costs passed through to the market.
Section 4.5.1 – Market fees	Page 22-23	The Offer Consultation Draft states that "*Fees that do not depend on the production of energy may not be included in offers*."[12] The AEC considers that it is not viable for generators to absorb market fees in an environment where they already recover insufficient revenue.[13] The AEC seeks clarification from the ERA on how generators can recover these market fees.
Section 4.6.1 Start-up costs	Page 24	Example 8 in the Offer Consultation Draft describes a situation where a Market Participant expects their plant to run for 60 dispatch and it amortises costs across the 250MWh it expects to produce. The Offer Construction Draft also states that "*In practice, at the time of making an offer to the market the duration of a dispatch cycle is uncertain. Market Participants may use their forecast and historical dispatch data to form a reasonable expectation of the duration of a dispatch cycle*."[14] This scenario highlights the risk of a generator forecasting that it is dispatched over 60 intervals, amortising start-up costs across this period, and then only generating for a much shorter timeframe and not recovering all of the start-up costs. The AEC considers that the ERA should give generators greater flexibility to:

[11] See 21, Offer construction guideline: draft for consultation
[12] See 23, Offer construction guideline: draft for consultation
[13] See Triennial review of the effectiveness of the Wholesale Electricity Market 2022 Discussion paper
[14] See 24, Offer construction guideline: draft for consultation

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Issue	Page number	AEC's comments
		1. Recover more of the start-up costs across the initial intervals to ensure that all of the costs are recouped. 2. Shape prices so that they can offer lower prices to ensure they can ramp up or ride through, and then recover the costs at later, higher priced intervals.
Section 4.6.3 – Avoided start-up-and shut-down costs	Page 26-27	Section 4.6.3 of the Offer Consultation Draft discusses how avoided costs should be included in offers. It uses an example of a coal-fired generator that cannot restart for four hours after a shutdown and provides an offer price of -$151/MWh to keep the facility operating at minimum generation. The rigid approach used in the Offer Consultation Draft ignores that many generators consider operational reasons when dispatching their facilities. For instance, a generator may prefer to bid at the floor price to ensure they are dispatched to ramp up for future higher-priced intervals, or the generator may seek to ride through a few negative-price intervals and remain online rather than being forced to shut down for an extended period. The risk of using avoided start-up costs to determine optimal offer strategies is that: 1. It may create unintended consequences. For instance, in the Offer Consultation Draft example, a change in the real-time price could mean that the coal generator is fully dispatched for an interval but is unable to accommodate the order. Alternatively, the coal generator may be cycled too frequently causing excess stress, increasing maintenance and shutdown and depreciation costs. 2. It may not allow facilities to operate commercially. An offer price based on avoided costs may not be low enough to ensure a facility is dispatched to ramp up or ride through. 'Capping' the minimum offer price to the avoided start-up costs will have a significant impact on generators and available generation. The AEC does not support setting a limit on the minimum offer price and encourages the ERA to take a practical approach, allowing generators to consider operational reasons when determining their bidding strategy.
Section 5.1 – Forecasting and uncertainty	Page 31	The Offer Consultation Draft comments that "*Market Participants are expected to forecast their run-time, production and costs using a simple, repeatable, and mechanistic method that accounts for, to the extent reasonable, AEMO's published Pre-Dispatch Schedules.* *Alternatively, a Market Participant may use its historical data to make judgements about its future production of electricity and update its assumptions as operations change over time.*"[15] For many generators, especially smaller ones with less sophisticated trading tools, the offer construction process is manual and based on subjective predictions and risk perceptions in real-time such that reverse engineering an offer to provide evidence to the ERA that every element was formed systematically is problematic. While components like fuel and VOM costs will generally be programmed, factors like opportunity costs and how these costs are amortised will

[15] See 31, Offer construction guideline: draft for consultation

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Issue	Page number	AEC's comments
		often be based on human judgement. The AEC supports other stakeholders[16] and recommends that the ERA: 1. Remove the expectation that each offer will be calculated using the same "repeatable" and "mechanistic" method. 2. Provide more detail about how they will assess and verify 'judgements' made by Market Participants.
Section 5.1 – Forecasting and uncertainty	Page 31	The Draft Report said: "*Given that there is uncertainty involved in forecasting future run times and production, a risk margin could be justified.* *Including a risk margin as an additional cost may be acceptable in some circumstances to cover extended runs of losses, but not to guarantee profits in the real-time market or STEM. To include a risk as a margin, a market participant would need to demonstrate why such a loss cannot be rectified by improving its forecasting methods.*"[17] However, the Offer Consultation Draft now does not include a risk margin and concludes that "*a Market Participant without market power would not include a risk margin in its price offers as an additional cost.*"[18] Market Participants will always be exposed to risk. Offers into the Short-Term Energy Market ("**STEM**") are made well in advance of the actual trading interval and are heavily influenced by forecast information published by the Bureau of Meteorology ("**BOM**"). However, Market Participants can't be expected to forecast weather better than the BOM when making their STEM offers, and nor can they perfectly predict changes in opportunity costs and price levels or the way other Market Participants behave. All of these factors regularly change and the cause of a forecast error in one interval may not be the same cause of an error in another interval. To make this even more challenging, accurately forecasting demand and dispatch volumes will become difficult as customer behaviour evolves and there is more penetration of Distributed Energy Resources and intermittent generation. The AEC considers that it is unreasonable for the ERA to assume that Market Participants have the capability to perfectly forecast and then have capacity to interrogate every interval and assess the cause of a forecast error, or that forecast errors can be perfectly evened out over time. The ERA's approach also raises the question of how generators will recover the costs of reviewing each interval to determine the cause of a forecast error. The ERA's proposal to eliminate a risk margin creates the potential for Market Participants to continually under-recover their costs at a time when generators are already earning insufficient revenue.[19] The AEC strongly encourages the ERA to:

[16] See for example, Alinta Energy's submission on Offer Construction Guideline: Draft Report
[17] See p17, Offer Construction Guideline: Draft Report
[18] See p31, Offer construction guideline: draft for consultation
[19] See Triennial review of the effectiveness of the Wholesale Electricity Market 2022 Discussion paper and see Reserve Capacity Mechanism Review Information Paper (Stage 1) and Consultation Paper (Stage 2)

Issue	Page number	AEC's comments
		1. Reintroduce a risk margin in the Offer Construction Guideline; and 2. Consider whether offers are reasonable at the time they are made, rather than require a participant to demonstrate why they were not able to perfectly manage unforeseen risk in their forecast.
Section 6.2 Coal-fired generator	Page 35-36	The AEC notes that in the Offer Consultation Draft, ramping costs are included for gas-fired generators as an avoidable fixed cost, however there is no provision for ramping costs for coal-fired generators. It says earlier in the Offer Consultation Draft that "*there may be cases where slow-ramping baseload generators may not be able to ramp quickly enough to produce at the level that would maximise their operating returns immediately after re-start. This missed opportunity in avoided start-up cost can be included in the calculation of amortised avoided start-up and shut-down cost but should not be double counted with ramping costs*."[20] The AEC asks the ERA to clarify how coal-fired generators claim ramping costs and suggests that ramping costs be included in Table 5.
Section 6.4 – Wind and solar generators	Page 38	The Offer Consultation Draft says that Start-up Costs are not applicable for wind and solar generators. The AEC asks the ERA to clarify how depreciation costs are recovered in offers from wind and solar assets.
Section 6.5 – Electric Storage Resources	Page 39-40	The Offer Consultation Draft says that Start-up Costs are not applicable for an ESR. The AEC asks the ERA to clarify how depreciation costs are recovered in offers from storage assets.
Section 10 – Record keeping	Page 51-52	Section 10.1 and 10.2 of the Offer Consultation Draft lists the records that owners must keep. The Offer Consultation Draft says "*These records include, but are not limited to:…*"[21] before providing a broad list in each section. This drafting allows for the ERA to require other, unspecified, records to be maintained by generators in addition to the already excessive list of data. This is a wide-reaching statement especially when applied to a significant matter such as offer construction. The ERA should explicitly state what other records need to be maintained. For many generators, especially smaller ones with less sophisticated trading tools, the offer construction process is manual and based on subjective predictions and risk perceptions in real-time such that reverse engineering an offer to provide evidence to the ERA that every element was formed systematically is problematic. While components like fuel and VOM costs will generally be programmed, factors like risk margins, opportunity costs and how these costs are amortised will often be based on human judgement. The AEC recommends that the ERA reduce the level of detail required in records of offer construction methods and remove the expectation that each offer will be calculated using the same "repeatable" and "mechanistic" method.

[20] See p27, Offer construction guideline: draft for consultation
[21] See p51-52, Offer construction guideline: draft for consultation

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Issue	Page number	AEC's comments
		The AEC also suggests that requiring records each time a decision is made to alter the offer price is excessive and duplicates the existing requirement to provide AEMO with a re-bid reason. While it is unclear what information is expected to be kept in these records, the AEC recommends that the ERA aim to apply a more practical standard: for example, records should provide a reasonable indication of how an offer was calculated, based on reasonable ranges of each offer component. It should not be required that participants have documented exactly how each offer component was calculated and amortised for each re-bid.

The AEC makes the following comments in relation to the Trading Consultation Draft:

Issue	Page number	AEC's comments
Section 3.1 – False, misleading or deceptive	Page 5	Example 1 in the Trading Consultation Draft provides a scenario where Generator D has a portfolio of three assets. Generator D trips one of its plants and it is taken offline for a day. However, because it was a hot summer day and Generator D knew if it took one plant offline on this day prices would spike and the other two plants would make more revenue, then Generator D is likely to have engaged in false, misleading and deceptive behaviour with the purpose of distorting or manipulating prices, in breach of clauses 2.16A.3(a) and 2.16A.3(c). It is unclear if the ERA is saying that Generator D purposely tripped one of its plants to make more revenue. Assuming that isn't the case, it would be reasonable to suggest that most portfolio owners know that, on certain occasions, they could make more revenue with less generators operating. However, simply 'knowing' this should not mean they have engaged in false, misleading and deceptive behaviour with the purpose of distorting or manipulating prices. The AEC considers that bad faith cannot extend to: 1. Simply 'knowing' that prices could be higher with less generation. 2. Or, a genuine fault occurring at one plant giving rise to the potential for other plants to earn more revenue. The AEC suggests that Example 1 in the Trading Consultation Draft creates confusion and may inadvertently capture most portfolio owners. The AEC encourages the ERA to clarify the example and confirm that bad faith does not extend to (a) 'knowing' that prices could be higher with less generation or (b) a genuine fault at one plant potentially increasing revenue at other plants.

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

Conclusion

The AEC appreciates this opportunity to provide feedback on the Offer Consultation Draft and Trading Consultation Draft, and encourages the ERA to consider the issues raised above.

Please do not hesitate to contact Graham Pearson, Western Australia Policy Manager by email on graham.pearson@energycouncil.com.au or by telephone on [redacted] should you wish to discuss this further.

Yours sincerely,

Graham Pearson
Policy Manager, Western Australia
Australian Energy Council

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone [redacted]
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083