



**SUBMISSION TO THE ECONOMIC REGULATION  
AUTHORITY**

**Discussion paper: Electricity Generation and Retail Corporation  
Regulatory Scheme: 2023 Effectiveness Review**

**13 October 2023**

## Executive Summary

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**Matter** Electricity Generation and Retail Corporation Regulatory Scheme: 2023 Effectiveness Review.

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

The ERA must deliver a report to the Minister for Energy (**Minister**) based on the review, not later than two months after the review is completed.

In conducting the review, in addition to compliance with the *Economic Regulation Authority Act 2003 (WA) (ERA Act)* and the general principles of administrative law, the ERA must have regard to the prevailing circumstances that exist in relation to the operation of the south west interconnected system (**SWIS**).

The ERA released its Electricity Generation and Retail Corporation regulatory scheme: 2023 effectiveness review discussion paper (**discussion paper**) on 15 September 2023 inviting public submissions from interested parties on issues that will assist the ERA in undertaking its sixth review.

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**Scope** The EGRC scheme consists of the:

- EGRC regulations.
  - *Segregation and Transfer Pricing Guidelines 2020 (segregation and transfer pricing guidelines)*.
  - The *Electricity (Standard Products) Wholesale Arrangements 2014 (standard product arrangements)*.
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**Key issues** From Synergy's perspective:

1. Market dynamics have rapidly changed during the EGRC scheme's sixth review period, evidenced by the Australian Energy Market Operator's (**AEMO**) 2023 Wholesale Electricity Market Electricity Statement of Opportunities – August 2023 (**ESOO**) and these developments warrant EGRC scheme design change.
2. Synergy supports the ERA's proposal to review the standard products buy-sell spread as part of the next (seventh) EGRC scheme review.
3. Synergy supports the ERA's proposal to change market participant eligibility to access standard products as it will limit Synergy's market risk and provide greater access to standard products by small retailers and generators than otherwise would be the case.
4. Synergy supports the intent behind introducing a threshold restricting access to standard products and considers it could effectively administer the standard products regime based on the ERA's proposed revised standard products eligibility criteria.
5. Synergy's cost in complying with EGRC scheme is significant, as is the adverse organisational burden on Synergy of complying with the EGRC scheme, in terms of limiting intra business segment cooperation, efficiencies, knowledge sharing and career development.

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6. Synergy considers there are a number of alternative regulatory mechanisms, checks and balances beyond the EGRC scheme that incentivise Synergy to behave competitively in the wholesale and retail electricity markets that limit the need for the EGRC scheme in its current form.
  7. There is no market need to ringfence Synergy's generation business segment (**Generation**) from its Trading (**Wholesale**) business segment. Further, the ESOO highlights a potential significant role for new private generation (potentially 945MW as early as in 2025/26) that warrants the ringfencing of Synergy's Customer (**Retail**) business segment from Wholesale to be reconsidered.
  8. Synergy supports the ERA's proposal that the EGRC scheme be amended to remove Synergy's obligations to undertake public segmented financial reporting and to remove the associated transfer pricing arrangements.
  9. Synergy supports option two in the discussion paper - the removal of the EGRC disclosure mechanism.
  10. Synergy does not support option one – that is, retention and amendment of the EGRC disclosure mechanism - and disagrees with the Frontier Economics' report recommendations in relation to the need to amend the existing disclosure mechanism on the basis that Synergy agrees with the ERA's assessment that market conditions make it improbable that Synergy would be able to engage in predatory pricing to eliminate its contestable retail market competitors.
  11. Synergy recommends the EGRC scheme audit requirements are amended to provide for audit frequency to be adjusted, ie reduced or extended, based on Synergy's EGRC scheme compliance performance to date.

The above matters are dealt with in more detail in this submission.

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## 1. Introduction

The ERA, as part of its 2021-2023 EGRC effectiveness review, is assessing the scheme's operation against the following objective:

*"To mitigate the potential for Synergy to exploit its market position as a dominant, vertically integrated electricity business, for the purposes of engaging in anticompetitive conduct, to the detriment of competing electricity generation and retail businesses and electricity customers."*<sup>1</sup>

The EGRC regulations, however, do not contain an objective. As in previous years, Synergy considers the primary focus of the ERA's review should be to assess the degree to which the EGRC scheme results in an operational framework that enables Synergy's business segments 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 should take a considered view of:

- Information provided by Synergy to the ERA in response to the ERA's information requests applicable to the sixth EGRC scheme review.
- The outcomes of the Auditor General calendar year and financial year audits.
- Regulatory costs and benefits associated with the EGRC regime (including the ERA's review of the effectiveness of that regime).
- Prevailing market circumstances at the time of the review.
- Commercial incentives that exist outside the EGRC scheme for Synergy to behave competitively.
- Potential effectiveness of alternative market monitoring or regulatory mechanisms to the EGRC scheme including general competition law provisions contained in the Commonwealth *Competition and Consumer Act 2010*.
- Whether the various regulatory arrangements are fair and reasonable to both market participants and Synergy and not solely market participants.

Given the above, and in Synergy's view there are compelling reasons to remove or amend a number of Synergy's ringfencing obligations under the EGRC scheme for the reasons set forth in this submission to enable Synergy to compete on a level playing field with its competitors.

## 2. The changing Western Australian electricity market

1 January 2024 will mark a decade since the EGRC scheme's commencement. Synergy's business and the Western Australian electricity market have changed much since then and will continue to change. The ES00<sup>2</sup> concluded:

- Supply-demand outlook indicates an urgent need for investment by capacity providers to supply the SWIS to meet the WEM reliability standard to address near-term reliability gaps projected for 2023-24 and 2024-25.

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<sup>1</sup> Refer ERA discussion paper page 3.

<sup>2</sup> Refer [https://wa.aemo.com.au/-/media/files/electricity/wem/planning\\_and\\_forecasting/esoo/2023/2023-wholesale-electricity-market-electricity-statement-of-opportunities-wem-esoo.pdf?la=en&hash=E05FBD7B0EEF023895B6360D590BAE26](https://wa.aemo.com.au/-/media/files/electricity/wem/planning_and_forecasting/esoo/2023/2023-wholesale-electricity-market-electricity-statement-of-opportunities-wem-esoo.pdf?la=en&hash=E05FBD7B0EEF023895B6360D590BAE26)

- The anticipated exit of coal-fired power generation capacity within the next decade will result in a substantial reduction in overall generation supply capacity.
- To meet the reliability gap and satisfy the RCR for 2025-26, expedited progress of a robust pipeline of probable projects is necessary.

The discussion paper acknowledges the fact that Synergy’s future net energy position is uncertain as it transitions from coal-fired generation to renewable energy and storage. Further, the discussion paper correctly notes if Synergy becomes a net purchaser of energy, selling energy forward through wholesale contracts will heighten Synergy’s exposure to variable spot market prices - increasing its risk profile and the cost of offering wholesale contracts. This is a markedly different situation to January 2014 where, at the time of the EGRC scheme’s inception, Synergy had an energy surplus via its own generation portfolio and contracts with competing generators and was considered to be a market maker by the ERA.

The EGRC scheme must evolve over time to reflect current market and Synergy circumstances. Regulation that was considered warranted in 2014 is not sustainable when prevailing circumstances have changed, specifically if Synergy may need to transition from a net seller to net purchaser of electricity. Should this scenario eventuate it will likely impact Synergy’s ability to offer wholesale contracts and standard products.

Synergy considers the discussion paper reasonably reflects changing market circumstances and, consequently, Synergy supports the ERA’s proposals to:

- Limit access to standard products to those entities without significant generation assets.
- Remove Synergy’s obligations to publish segmented financial statements and apply transfer pricing.

### 3. Wholesale contract price influence

**1. What alternatives to Synergy’s wholesale electricity contracts (customised and standard products) exist, and are the prices - and other terms and conditions - comparable to Synergy’s wholesale electricity contracts?**

Not applicable to Synergy.

**2. Do stakeholders see the continuing need for Synergy’s standard products? Please explain your reasoning and provide any evidence in support of your feedback.**

Not applicable to Synergy.

The Minister reduced the buy-sell price spread from 20 per cent to 15 per cent from July 2022. The ERA has not made recommendations in relation to the appropriateness of the buy-sell spread in its 2021-23 review but will evaluate the current spread’s appropriateness in the next review (due for completion by December 2025) when sufficient information becomes available. Synergy supports the ERA’s review approach.

### **3. How would the ERA's proposal for limiting the scope of provision of standard products affect your business?**

The ERA is proposing a standard products eligibility threshold based on market participants' generation and load requirements with the objective of encouraging and diversifying user access and uptake in standard products. Synergy supports the ERA's proposal on the basis that:

- Synergy is the sole supplier of standard products in the WEM, consequently it assumes the entire risk from speculative trades of standard products. Limiting parties who have significant access to generation assets will reduce Synergy's financial risk in offering standard products.
- It will better assist entities without access to significant generation assets to access standard products because more electricity trades will be available to them than otherwise would be the case.
- It recognises the ESOO supply-demand outlook that there is an urgent need for investment by capacity providers to supply the SWIS. Limiting access to standard products to small retailers and generators will assist Synergy to manage the potential risk of transitioning from a net seller to net purchaser of electricity, if required.

Whilst details of the actual standard products threshold are yet to be determined, Synergy considers conceptually it could effectively administer the standard products regime based on the ERA's proposed approach.

### **4. How can a threshold be established to restrict certain market participants from accessing Synergy's standard products (for example, entities with a low ratio of generation capacity to load or vice versa)?**

Synergy supports the intent behind introducing a threshold restricting access to standard products and considers conceptually it could effectively administer the standard products regime based on the ERA's proposed revised standard products eligibility criteria.

## **4. Ringfencing costs**

### **5. What costs and benefits do stakeholders see in keeping the EGRC scheme's ringfencing obligations on Synergy?**

Synergy estimates the cost of complying with the EGRC scheme is in excess of \$1M in CY2023. Synergy has previously provided the ERA with details of these costs.

To facilitate Synergy's compliance with the EGRC scheme requirements, Synergy has established and maintains an EGRC compliance management framework. Key elements include:

- Allocated governance full time employees.
- An enterprise governance risk and compliance system that includes an EGRC control register, incident management workflow, system reporting and regulatory obligation calendar.

- Bespoke on-line training and monitoring to ensure staff who can access restricted information undergo training on the obligations imposed on Synergy at least annually - approximately 870 personnel underwent training in FY22/23.
- Board-approved ringfencing enterprise protocol that specifies minimum compliance requirements and performance across the business.
- Controlled document management.
- Employee arrangements that provide for management roles to be separated between the Retail, Wholesale and Generation business segments.
- Enterprise ringfencing compliance coordinator framework.
- Information technology systems access, security permission management and monitoring to prevent retail-restricted information from being disclosed to Retail staff and generation restricted information from being disclosed to Generation staff.
- Internal governance reviews.
- Regulatory guidance (fact sheets, guidelines, presentations, intranet portal).
- Separate work area for the Wholesale business segment with secure card access limited to non-generation and retail personnel.

The EGRC regulations require Synergy to develop, implement and maintain controls that limit access to information systems to ensure compliance with the non-disclosure of restricted information provisions. This means Synergy cannot achieve economies of scale in relation to the Wholesale business segments' systems by eliminating such matters as:

- Creation and ongoing maintenance of transfer pricing arrangements, systems, processes and business segment level sub-portfolios and hedging arrangements which do not affect Synergy's gross profit.
- Duplicating the storage of documents in both restricted and non-restricted areas.
- Duplication of the preparation and presentation of Wholesale market materials.
- Excluding ringfenced personnel from discussions of strategic importance to Synergy.
- Excluding ringfenced Synergy subject matter experts (data scientists, analysts etc) from Wholesale projects which would benefit from relevant expertise.
- Isolating ringfenced data tables and duplicating non-ringfenced data tables.
- Separating IT infrastructure and databases and controlling access.

The above outcomes create unnecessary duplication and operational inefficiencies that Synergy's Generation and Retail competitors do not incur.

Internal staff movements (secondments, graduate rotations, acting arrangements, coaching, mentoring and general career development) are common within Synergy. The EGRC regulations' requirement for Synergy to take steps to minimise the disclosure of restricted information imposes a significant impost on Synergy as it has to monitor each and every staff movement. (System capability has been built to undertake this.) Whilst some staff movements do not require prior controls to be implemented, a number of staff movements do. Such controls include:

- Removing or quarantining system, email and document access.
- Interviewing staff and obtaining written undertakings in relation to non-disclosure or use of specified information.
- Removal from internal communication distribution lists.
- Disposal or archiving of hard copy or electronic files.

Synergy estimates that a single staff movement can cost up to \$1,140 (excluding the capital cost of establishing and maintaining system staff movement monitoring capability) to ensure restricted information preventative steps are undertaken.

Synergy considers there are a number of alternatives, checks and balances beyond the EGRC scheme that incentivise Synergy to behave competitively in the wholesale and retail electricity markets and therefore limit the need for the EGRC scheme in its current form. These include:

- *Consumer and Competition Act 2010 (Cth)*<sup>3</sup>.
- State Government setting of regulated tariffs, fees and charges.
- ERA statutory information gathering powers under the ERA Act which enable the ERA to evaluate hypotheses such as margin squeeze.
- The ability for the State Government, under the ERA Act, to provide the ERA with terms of reference to review such matters as wholesale contract arrangements.
- New market power mitigation WEM rules that commenced on 1 October 2023.

**6. What benefits might arise from the current requirement for restricting the flow of 'generation restricted' wholesale information from Synergy's wholesale business to its generation business?**

Synergy considers the EGRC scheme obligations to ringfence the Generation business segment from the Wholesale business segment in relation to:

- physical office separation
- non-disclosure of generation restricted information
- segmented reporting,

do not deliver market value but result in cost and business inefficiency. In Synergy's view these obligations can be removed with little or no risk as the anti-competitive conduct envisaged when the EGRC scheme was created is unlikely to occur in current and forecast future market conditions. Synergy's Generation and Wholesale business segments should be permitted to compete with private gentailers on an equal regulatory basis / level playing field.

From Synergy's perspective, permitting Generation to have access to generation restricted information poses minimal market risk in terms of the business segment obtaining an unfair market advantage by being able to access such information. It is unclear how Generation could use generation restricted information to obtain an unfair market advantage over its competitors given it is Wholesale that dispatches Synergy's generation on an individual plant basis since 1 October 2023 (and prior to this on a portfolio basis).

The EGRC regulations require a series of tests to be undertaken to determine whether information is generation restricted information:

1. Does the information relate to a generation competitor?
2. Was the information obtained by or provided to the Wholesale business during the conduct of Wholesale's operations?

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<sup>3 3</sup> Refer section 46 of the Act.



3. If the information were disclosed to Generation personnel would the information reasonably be expected to materially adversely affect a Generation competitor?

If the answer to all three questions is yes, then the information is generation restricted information and cannot be disclosed to Synergy's Generation business segment by Wholesale unless the restricted information is:

1. publicly available at the time the disclosure is made; or
2. the restricted information disclosure is required by law.

The requirement for Wholesale to assess information prior to sharing it with Generation has resulted in Synergy adopting a conservative approach to what information is shared between the two business segments. For example, rather than having to undertake a ringfencing assessment each and every time a commercial matter is to be discussed or shared between Trading and Generation, the conservative approach has been to not share the information or for Generation not to seek information for risk of contravening of the EGRC regulations.

Further, the EGRC regulations require Wholesale staff who can, or could, access generation restricted information to be physically separated from Generation staff. This limitation results in business inefficiency due to:

- An inability to co-locate market traders and plant operators at the Pinjar Control Room or Wholesale's 24/7 trading room at Synergy's head office for both areas to get a better understanding on how each business segment performs its operational functions.
- Loss of inter-business segment collaboration and sharing of opinions, knowledge and experience. This is problematic at new WEM commencement whereby it is a business (and market imperative) that Wholesale and Generation work closely together to ensure WEM readiness, operation and compliance.

## 5. Disclosure mechanism

Synergy concurs with the ERA's conclusion that the existing disclosure mechanism does not provide sufficient relevant information to allow other parties to detect anti-competitive behaviour and that other mechanisms exist that reduce the need for a disclosure mechanism. Synergy supports the ERA's proposal that the EGRC scheme's obligations be amended to not oblige Synergy to prepare segmented financial statements for public disclosure and to remove the associated transfer pricing arrangements as they do not benefit market participants or consumers.

### **7. Do stakeholders use Synergy's segmented financial reports to detect anti-competitive behaviour or for other reasons? What challenges do stakeholders face when assessing the disclosed information?**

Synergy considers the current disclosure mechanism, in the form of segmented financial statements applicable to its Wholesale, Retail, Generation and Shared Services Operations business segments, is an ineffective benchmarking mechanism from which to consider anti-competitive conduct. The requirement to segment accounts imposes a significant overhead on Synergy to prepare such accounts and for the Auditor General to audit.

The energy market has changed significantly since 2014 and many new market arrangements have evolved that were not contemplated by the EGRC regulations. New business activity has resulted in Synergy having to divert staff with business expertise and acumen to undertake administrative tasks to ensure its financial accounts meet the EGRC regulation requirements.

For example, in the case of electric vehicle charging facilities, Synergy has had to spend unnecessary time and cost to determine which business segments can perform a particular electric vehicle supply chain function and ensure that the associated costs are assigned appropriately across the Generation, Shared Services Operations and Retail business segments on such matters as:

- Land access, acquisition and title management.
- Electric vehicle charging technology identification, procurement, installation, operation and maintenance.
- Network connection, reference service selection, charges payment and invoice reconciliation.
- Customer payment platform selection, procurement, systems integration and vendor management.
- Electric vehicle charging station marketing and point of sale.

Rather than relying on segmented reporting, Synergy's notes the ERA possesses and exercises significant statutory information gathering powers<sup>4</sup> to obtain information with which to assess market conduct. In relation to the 2023 EGRC effectiveness review, Synergy notes it has provided hundreds of commercially sensitive documents to the ERA in relation to its trading and retail activities making the need for segmented reporting redundant.

Given the above, Synergy supports the ERA's proposal to remove:

- the requirement for Synergy to prepare and publish segmented quarterly financial reports under EGRC regulation 6; and
- the non-discrimination provisions under EGRC regulation 22(a).

The ESOO highlights a potential significant role for new private generation (potentially 945MW as early as in 2025/26) that warrants the ringfencing of Retail's business segment from Wholesale to be revisited, for example, regulation 22(b). In a situation where Synergy has a need to transition from a net seller to net purchaser of electricity, it should have the opportunity to compete with other gentailers in the market on a level playing field.

## 6. Transfer pricing

**8. What benefits do stakeholders receive from Synergy maintaining the transfer pricing mechanism (applicable to both foundation and new customers)?**

**9. How would the removal of transfer pricing arrangements affect market participants?**

The discussion paper notes that the determination of an internal transfer price does not provide any benefits for market participants, as there is no requirement for Synergy to publish or use its transfer prices when preparing segmented financial statements or determining retail prices. Synergy agrees

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<sup>4</sup> For example, refer section 51 of Economic Regulation Authority Act 2003.

with the ERA's comments regarding the transfer pricing mechanism and supports the removal of the transfer pricing mechanism requirement.

## 7. Options assessment summary

### 10. Would option one or option two be more likely to improve the effectiveness of the EGRC Scheme? Why?

Synergy supports option two for the reasons set out in this submission.

Synergy does not support option one.

The discussion paper (Appendix 4) contains a report by Frontier Economics which was engaged by the ERA to review the current EGRC disclosure mechanism. Option one is based on the Frontier Economics' report that proposed five recommendations to improve the EGRC disclosure mechanism to reduce the risk of Synergy engaging in a price squeeze and some forms of cross subsidisation.

Synergy does not agree with Frontier Economics' recommendations on the basis that:

- Frontier Economics has not substantiated a demonstrable need for such changes i.e. it has not presented evidence of market failure that warrants such additional intervention.
- The State Government has previously considered the need for greater segmented reporting and determined there was no reason to increase the level of segmentation of Synergy's financial statements given the ERA's existing information gathering powers.<sup>5</sup>
- The report does not take into account the circumstance that Synergy is not able to set its own retail tariffs for residential and small to medium businesses. Synergy is the only electricity retailer within the SWIS that has regulated electricity tariffs, fees and charges and the only retailer that has an obligation to offer to supply electricity at regulated tariffs under its ERA approved standard form contract. Synergy's regulated tariffs, fees and charges are set by the State Government as part of the annual State Government budget process. Accordingly, Synergy's ability to price squeeze via cross subsidisation between franchise and contestable customers is limited by State Government oversight.
- The report did not consider or assess the ESOO that highlighted procurement of additional capacity is required within the SWIS to address near-term reliability gaps projected for 2023-24 and 2024-25. Further, the report did not reconsider the potential for price squeeze should Synergy become a net buyer of electricity during this period.
- The report does not recognise that the ERA has significant statutory powers to require Synergy to provide a range of information to the ERA for it to assess whether price or margin squeeze is occurring or has occurred.
- The report did not substantiate why the EGRC disclosure mechanisms need to be reinforced given the existence of the *Consumer and Competition Act 2010* (Cth) that, amongst other matters, prohibits misuse of market power which includes predatory pricing.

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<sup>5</sup> Refer [https://www.wa.gov.au/system/files/2019-08/Electricity-Generation-and-Retail-Corporation-Regulatory-Scheme-June-2019\\_0.pdf](https://www.wa.gov.au/system/files/2019-08/Electricity-Generation-and-Retail-Corporation-Regulatory-Scheme-June-2019_0.pdf) refer page 22

## 8. Other matters

### 8.1 Financial and calendar year audits

Under Part 4 of the EGRC regulations, the Auditor General is required to audit the EGRC scheme each year. The Auditor General is required to undertake a:

- calendar year audit, which reviews compliance with segregation obligations including disclosure of restricted information, information technology controls, training, separate work areas and separation of management roles; and
- financial year audit which reviews compliance with segmented reporting, standard products and wholesale arrangements.

If the Auditor General forms an opinion Synergy has not complied with one or more provisions of the EGRC regulations, the ERA has the function to investigate the matter. Since the EGRC scheme commencement, Synergy has been subject to more than 16 audits. Synergy has satisfactorily met the EGRC scheme's audit requirements consistently.

Synergy considers the current level of audit and review is onerous and inconsistent with good regulatory practice. Good regulatory practice incentivises market participants to attain positive compliance behaviour by extending the regulatory audit period in response to good compliance performance and conversely addressing poor compliance by increasing audit frequency. However, as the requirement to undertake annual calendar year and financial year audits is prescribed in the EGRC regulations, the audits must occur irrespective of Synergy's audit performance. This is in contrast to the ERA's utility licensing performance audit approach where audit frequency changes based on licensee compliance performance.

An EGRC scheme that permits audit frequency to change based on Synergy's compliance performance would reduce both Synergy's and the Auditor General's costs and recognise Synergy's consistent and compliant behaviour.