



Economic Regulation Authority

# Offer construction guideline and trading conduct guideline

Draft report

5 September 2024

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At the ERA we value our cultural diversity and respect the traditional custodians of the land and waters on which we live and work.

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## Invitation to make submissions

**Submissions are due by 4:00 pm WST, Thursday, 3 October 2024**

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](mailto: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](mailto:info@erawa.com.au).

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## Executive summary

The Wholesale Electricity Market (WEM) in the South-West Interconnected System operates under the *Electricity Industry Act 2004*, *Electricity Industry (Wholesale Electricity Market) Regulations 2004*, and Wholesale Electricity Market Rules.<sup>1,2,3</sup>

Market participants operating in the WEM must comply with the trading obligations specified in the WEM Rules. To assist market participants' understanding of their obligations, the WEM Rules require the Economic Regulation Authority to develop and maintain an Offer Construction Guideline (OCG) and a Trading Conduct Guideline (TCG).<sup>4</sup>

The ERA has a broad function to monitor the market for compliance with the WEM Rules and investigate behaviour if it considers the behaviour has resulted in the market not functioning effectively.<sup>5</sup> The OCG and TCG inform participants of the types of conduct and indicators of non-compliance the ERA will be monitoring.

The obligation to comply is binding on all participants in the Short-Term Energy Market (STEM) and Real-Time Market, which includes the energy and the Frequency Co-optimised Essential System Services (FCESS) markets.<sup>6,7,8</sup>

In May 2024, Energy Policy WA (EPWA) commenced review of the framework for FCESS to ensure it operates efficiently and power system security and reliability can be maintained at the lowest cost to consumers.<sup>9</sup>

On 9 August 2024, EPWA released Exposure Draft of the FCESS Cost Review Amendments (Exposure Draft) for the WEM Rules proposing several changes to market participants' trading obligations, such as removing the need to demonstrate that a market participant had power when formulating their offers.<sup>10</sup> The ERA proposes to amend the OCG and TCG to align with these changes and the following provisions in the WEM Rules:

- Market participants cannot make an Irregular Price Offer that results in an inefficient market outcome, where an Irregular Price Offer is inconsistent with an Economic Price Offer. Economic Price Offer is an offer which is not greater than the sum of all efficient

<sup>1</sup> *Electricity Industry Act 2004* (WA), ([online](#)).

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

<sup>3</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, ([online](#)).

<sup>4</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16D.1 ([online](#)).

<sup>5</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.13.2 ([online](#)).

<sup>6</sup> Frequency Co-optimised Essential System Services (FCESS) is a type of Essential System Services, which support the operation of the energy market and are required to maintain power system security and reliability. FCESS include Regulation, Contingency Reserve, and Rate of Change of Frequency Control Service. See: Wholesale Electricity Market Rules (WA), 27 July 2024, Chapter 11 ([online](#)).

<sup>7</sup> STEM is a forward market operated by AEMO in which Market Participants can trade electricity supplementing their off-market agreements for supply of electricity. See: Wholesale Electricity Market Rules (WA), 27 July 2024, Chapter 6 ([online](#)).

<sup>8</sup> Real-Time market allows AEMO to dispatch energy and FCESS services in real time as market participants' actual production and consumption may differ from their forward contracts. See: Wholesale Electricity Market Rules (WA), 27 July 2024, Chapter 7 ([online](#)).

<sup>9</sup> Energy Policy WA, 29 May 2024, *Scope of Work for the Coordinator's Review of the Essential System Services Framework*, ([online](#)).

<sup>10</sup> Energy Policy WA, 9 August 2024, *FCESS Cost Review – Exposure Draft, Proposed Wholesale Electricity Market (WEM) Amending Rules, Part 2*, ([online](#)).

variable costs of providing the market service, including all costs incurred under long-term take-or-pay fuel contracts.<sup>11,12</sup>

- Market participants must avoid conduct that is false, dishonest, or has the purpose or the effect of distorting or manipulating prices in the WEM.<sup>13</sup>

This draft report outlines the ERA's reasons for its proposed amendments to the guidelines, which include:

- Removing references to market power and the WEM Rules that are to be deleted.
- Introducing new examples based on the ERA's experience in monitoring the market since October 2023.<sup>14</sup>
- Changing treatment of runways cost for Contingency Reserve Raise.<sup>15</sup>

The ERA expects to complete its review of the guidelines by 20 November 2024, which is when EPWA's proposed WEM Rule changes are expected to come into effect.

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<sup>11</sup> Energy Policy WA, 9 August 2024, *FCESS Cost Review – Exposure Draft, Proposed Wholesale Electricity Market (WEM) Amending Rules*, Part 2, ([online](#)).

<sup>12</sup> Efficient Variable Cost (EVC) is defined in the OCG. Generally, the EVC is the cost that relates to the production of electricity or the relevant FCESS service and varies depending on the level of production. The EVC can include some costs which are independent of the production levels, such as costs to start-up a plant. Revised Offer Construction Guidelines is available in Appendix 1. See: Economic Regulation Authority, 6 September 2024, Draft Offer Construction Guideline, ([online](#)).

<sup>13</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16A.3 ([online](#)).

<sup>14</sup> New market commenced on 1 October 2023.

<sup>15</sup> Contingency Reserve Raise is a type of FCESS service which operates during times of significant loss of generation to restore frequency in the South West Interconnected System. It is measured in MW of response capability. See: Wholesale Electricity Market Rules, 24 July 2024, rule 3.9.5 ([online](#)).

# 1. Introduction

To ensure the WEM operates effectively, the WEM Rules establish the general trading obligations for the market participants. Since the start of the new market in October 2023, these obligations have included:

- Offering prices that reflect only the costs that a market participant without market power would include in a profit-maximising price offer.<sup>16</sup>
- Avoiding conduct that is false, dishonest, or has the purpose or the effect of distorting or manipulating prices in the WEM.<sup>17</sup>

The obligations were binding on all participants in the STEM and Real-Time Market, including the FCESS and energy markets. The ERA monitors and enforces compliance with the WEM Rules.

In September 2023, the ERA published the OCG and the TCG to provide participants regulatory guidance on the general trading obligations. The TCG provided guidance about the conduct prohibited under the WEM Rules while the OCG concerned the price offer obligations in WEM Rule 2.16A.1.<sup>18</sup> Rule 2.16A.2 states that for a breach of Rule 2.16A.1 to have occurred a market participant must have market power at the time of making the offers in question. Rule 2.16E.1 requires that a breach of Rule 2.16A.1 requires that an inefficient market outcome has occurred.

Concurrently, Rule 2.16C.5 requires that a market participant not make an Irregular Price Offer that results in an inefficient market outcome, where an irregular price offer is defined as a price that was inconsistent with the price that a Market Participant without market power would offer in a profit-maximising Real-Time Market for STEM offers (Rule 2.16C.6(c)) and the Real-Time-Market (Rule 2.16C.6(d)).

On 9 August 2024, EPWA proposed to change the WEM Rules, including deleting WEM Rules 2.16A.1 and 2.16A.2. The ERA proposes to amend the OCG and TCG in line with EPWA's Exposure Draft, in time for these amended Rules to come into effect in November 2024.

To conduct its review, the ERA must follow process stipulated in the WEM Rules. This process is outlined in section 1.1.

This report is organised as follows:

- The rest of Chapter 1 summarises EPWA's proposed changes and the process to update the guidelines under the WEM Rules.
- Chapter 2 explains the scope of the ERA's review of the guidelines.
- Chapter 3 outlines proposed changes to the OCG.
- Chapter 4 outlines proposed changes to the TCG.
- The amended guidelines are provided in Appendices 1 (OCG) and 2 (TCG).

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<sup>16</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16A.1 ([online](#))

<sup>17</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16A.3 ([online](#))

<sup>18</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16D.1 ([online](#))



## 1.1 Updating the guidelines

The ERA can amend the guidelines at any time following the process specified in the WEM Rules.<sup>19</sup>

The WEM Rules require the ERA to publish on its website the following:<sup>20</sup>

- A draft report containing a copy of the proposed amendments to the guidelines, as applicable, and a request for submissions.
- The closing date for submissions, which must be no earlier than four weeks after the date of publication of the draft report.
- A copy of all submissions received. If a submission contains information that the ERA reasonably considers to be confidential, the ERA may redact that information to the extent it considers appropriate.

Following the closing date for submissions on the draft report, the ERA must publish a final report on its website containing the following:<sup>21</sup>

- The amendments to the guidelines.
- The reasons for the amendment to the guidelines.
- A summary of any submission received by the ERA on the draft report that were received within the time specified, and any late submissions the ERA has decided to take into account.
- The ERA's responses to the issues raised in those submissions.
- Any other matters the ERA considers relevant to the amendments to the guidelines.
- The date that the amendments to the guidelines will commence.

## 1.2 Proposed WEM Rule changes

As part of its Exposure Draft, EPWA proposed several amendments to the market participants obligations under the WEM Rules.

These amendments would change the ERA's process for determining whether an Irregular Price Offer occurred, by:

- Deleting WEM Rule 2.16A.1, which requires market participants to offer prices reflecting only the costs that a market participant without market power would include in a profit-maximising price offer.
- Removing the existing requirement in the WEM Rule 2.16A.2 for the ERA to infer if a Market Participant had market power at the time of constructing offers in the Real-Time Market or STEM as part of its determination whether an Irregular Price Offer occurred.
- Amending the definition of an Irregular Price Offer by making a reference to the newly defined term Economic Price Offer.

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<sup>19</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16D.2 ([online](#))

<sup>20</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16D.3 ([online](#))

<sup>21</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16D.4 ([online](#))

- The WEM Rule 2.16C.5 will be the sole provision dealing with offers into the market. The rule prohibits making Irregular Price Offers which lead to inefficient market outcomes.<sup>22</sup>

Under the proposed definition, an Economic Price Offer means an offer that is not greater than the sum of all efficient variable costs for the provision of the relevant market service, including costs incurred under long-term take-or-pay contracts.<sup>23</sup> Market participants will be required to offer price to the real time market and in the STEM that is consistent with an Economic Price Offer regardless of the participant's market power.<sup>24</sup>

Other relevant changes to the WEM Rules proposed by EPWA are:

- Introducing new WEM Rule 2.16C.8A to ensure that the six-month timeframe for the ERA's determination of whether an Irregular Price Offer has occurred, and whether it has resulted in an inefficient market outcome, does not include the time market participants take to provide the ERA with information. This is to apply if the ERA requests information from a market participant under the WEM Rule 2.13.28 or a submission under the WEM Procedure: Monitoring Protocol.<sup>25,26</sup>
- Removing WEM Rule 2.16C.11 that is based on the to-be-deleted WEM Rule 2.16A.1.
- Removing WEM Rule 2.16E.1 which refers to the to-be-deleted WEM Rule 2.16A.1.
- Amending WEM Rule 2.16E.2 to reflect provisions in WEM Rule 2.16C.6 under which the ERA investigates whether a price offer is an Irregular Price Offer.
- Changing the name "Market Power Test" in Rule 2.16C to "Materiality Test", as the current name does not accurately reflect the purpose of the test. The test in Rule 2.16C is not an assessment of market power but rather aims to oblige a material portfolio or material constrained portfolio to maintain data and records.<sup>27,28</sup>

The proposed changes aim to improve effectiveness of the market power mitigation framework and market efficiency by ensuring market participants' offers reflect their efficient variable costs.

<sup>22</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16C.5 ([online](#)).

<sup>23</sup> Energy Policy WA, 9 August 2024, *FCESS Cost Review – Exposure Draft, Proposed Wholesale Electricity Market (WEM) Amending Rules*, rule 2.16C.6A, ([online](#)).

<sup>24</sup> Energy Policy WA, 9 August 2024, *FCESS Cost Review – Exposure Draft, Proposed Wholesale Electricity Market (WEM) Amending Rules*, rule 2.16C.6, ([online](#)).

<sup>25</sup> Economic Regulation Authority, 1 October 2023, *WEM Procedure: Monitoring Protocol*, ([online](#)).

<sup>26</sup> Monitoring Protocol is being revised due to EPWA's proposed changes. A copy of the revised Monitoring Protocol open for public submissions can be found on the ERA's website ([online](#)).

<sup>27</sup> Material portfolio refers to a set of one or more facilities (Portfolio) that meets or exceeds the 10 per cent threshold of the total net load available for supply of the network from all identified Portfolios. See: Energy Policy WA, 9 August 2024, *FCESS Cost Review – Exposure Draft, Proposed Wholesale Electricity Market (WEM) Amending Rules*, rule 2.16C.1, ([online](#)).

<sup>28</sup> Material constrained portfolios are those registered facilities that have potential to hold localised market power due to network constraints resulting in energy uplift payments. See: Energy Policy WA, 9 August 2024, *FCESS Cost Review – Exposure Draft, Proposed Wholesale Electricity Market (WEM) Amending Rules*, rule 2.16C.2, ([online](#)).

## 2. Scope of the ERA's review

The ERA has a broad function to monitor the market for compliance with the WEM Rules and investigate behaviour if it considers the behaviour has resulted in the market not functioning effectively.<sup>29</sup>

The OCG and TCG 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.<sup>30</sup>

In this review, the ERA has primarily focused on implementing EPWA's proposed changes in the Exposure Draft. The ERA has made further amendments to the guidelines to correct minor errors, improve market efficiency, and include new examples based on the ERA's experience monitoring the market since 1 October 2023.

### 2.1 Matters outside the scope of this report

The ERA's WEM Procedure: Monitoring Protocol sets out how the ERA monitors, investigates, and enforces compliance. The ERA proposes to update the Monitoring Protocol in line with EPWA's proposed WEM Rule amendments and will separately publish a procedure change proposal setting out these changes.<sup>31</sup>

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<sup>29</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.13.2 ([online](#))

<sup>30</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16A.3 ([online](#))

<sup>31</sup> A copy of the revised Monitoring Protocol open for public submissions and associated procedure change proposal can be found on the ERA website ([online](#)).

### 3. Offer Construction Guideline

The OCG outlines the general trading obligations of the market participants in the STEM and Real-Time Market, including the FCESS markets.

To form price offers consistent with Economic Price Offers in the WEM Rules, a Market Participant can offer a price up to the sum of all efficient variable costs for the provision of energy or FCESS service, including costs incurred under long-term take-or-pay contracts. Consequently, the ERA proposes mostly limited changes summarised in section 3.1.

#### 3.1 Proposed changes to the OCG

In view of EPWA's proposed changes in the Exposure Draft, the ERA proposes the following amendments to the OCG:

- Deleting references to WEM Rule 2.16A.1 and WEM Rule 2.16A.2, as these are proposed to be removed. Where relevant, these references will be replaced with references to WEM Rule 2.16C.6A (or Economic Price Offers) or WEM Rule 2.16C.5.
- Removing references to the ERA's obligation to determine that the market participant had market power at the time of offering the relevant prices in the STEM submission or Real-time market submission.
- Deleting reference to the to-be-removed WEM Rule 2.16C.11 that is based on WEM rule 2.16A.1.
- Removing section 3 which explains how the ERA tests for the presence of market power.
- Noting record keeping obligations for material and/or material constrained portfolios.
- Introducing a new example based on the ERA's observations in monitoring the market since 1 October 2023. Example 20A explains the costs which can be claimed in the FCESS market for a Contingency Reserve Raise if market participant's maximum capacity is higher than its enablement maximum for Contingency Reserve Raise.
- Updating figures (where relevant) to the more current numbers (such as the Australian Energy Market Operator's market fees).
- Correcting some minor errors and improving readability.

##### 3.1.1 *Runway cost allocation for Contingency Reserve Raise*

Additionally, the ERA seeks industry feedback on its proposal to amend provisions in the OCG relating to allocation of runway costs for Contingency Reserve Raise.

The runway cost represents price of procuring the Contingency Reserve Raise to cover loss of the largest energy supplier for a given interval. The WEM Rules describe method, known as runway share calculation method, to recover this cost from generators operating in the interval. The runway method allocates contingency reserve costs to causers of contingencies, equivalent with the extent to which they have contributed to the procurement of Contingency Reserve Raise requirement. In other words, the largest contingency on the network bears the highest runway cost.

To improve market efficiency, the ERA proposes for the OCG to specify that runway costs for Contingency Reserve Raise do not constitute efficient variable costs and, therefore, should not be included into participant's energy offers.

The ERA understands that this is a complex issue and the ERA's proposal may prevent some generators from recovering their runway FCESS costs and welcomes market participant feedback and suggestions.

## 4. Trading Conduct Guideline

The TCG aims to provide clarity and guidance regarding the prohibited conduct described in WEM Rule 2.16A.3:<sup>32</sup>

A Market Participant must not engage in conduct in the STEM or Real-Time Market that:

- (a) is false, misleading or deceptive, or likely to mislead or deceive;
- (b) is fraudulent, dishonest or in bad faith; or
- (c) has the purpose, or has or is likely to have the effect, of distorting or manipulating prices in the Wholesale Electricity Market.

### 4.1 Proposed changes

The ERA proposes the following changes to the TCG:

- Change due to amendments to the test name in WEM Rule 2.16C from “Market Power Test” to “Materiality Test”.
- Adding a note explaining when it is no longer mandatory for a facility to accredit for FCESS.
- Changing references from WEM Rule 2.16A.1 to WEM Rules 2.16C.4, 2.16C.5, or 2.16C.6.
- Minor changes in Examples 4 and 5 to better reflect the operation of the new market.
- Adding new examples based on the ERA’s observations in monitoring the market since 1 October 2023:
  - Example 8 illustrates when withholding capacity will have effect of distorting energy prices and may be in breach of WEM Rule 2.16A.3.
  - Example 9 explains when application of avoidable fixed costs may result in breach of WEM Rule 2.16A.3.
- Minor grammatical changes.
- Improving readability.

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<sup>32</sup> Wholesale Electricity Market Rules (WA), 27 July 2024, rule 2.16D.1(b) ([online](#))

## **Appendix 1 Offer Construction Guideline (amended)**

The Offer Construction Guideline containing the ERA's proposed changes is available on the ERA's website ([online](#)).

## **Appendix 2 Trading Conduct Guideline (amended)**

The Trading Conduct Guideline containing the ERA's proposed changes is available on the ERA's website ([online](#)).