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Submission: ACCC draft guidelines on Prohibited Conduct in the Energy Market

CS Energy welcomes the opportunity to provide a submission to the Australian Competition and Consumer Commission (**ACCC**) on its draft “Guidelines on Part XICA – Prohibited conduct in the energy market” (**Draft Guidelines**). The Draft Guidelines set out the ACCC’s approach to the interpretation and enforcement of the three new conduct prohibitions introduced to the *Competition and Consumer Act 2010* (Cth) (**CCA**) by the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Act 2019* (Cth) (**PEMM Act**).

About CS Energy

CS Energy is a Queensland energy company that generates and sells electricity in the National Electricity Market (**NEM**). CS Energy owns and operates the Kogan Creek and Callide coal-fired power stations. CS Energy sells electricity into the NEM from these power stations, as well as electricity generated by other power stations that CS Energy holds the trading rights to.

CS Energy also operates a retail business, offering retail contracts to large commercial and industrial users in Queensland, and, is part of the South-East Queensland retail market through our joint venture with Alinta Energy.

CS Energy is 100 percent owned by the Queensland government.

General comments

The PEMM Act introduces three new types of conduct prohibitions specific to the electricity sector, with new and severe remedies proposed for a breach of these prohibitions. Through each stage of the legislative process, industry has been consistent in its feedback that the conduct prohibitions create vague and uncertain obligations as to whether behaviour is or is not prohibited conduct.

Obtaining clarity in the interpretation and enforcement of the conduct prohibitions is vital to delivering confidence to electricity industry participants as to how to interpret and apply

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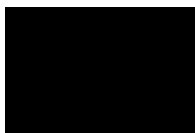
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the law. While CS Energy considers the Draft Guidelines do assist in alleviating this uncertainty, CS Energy has identified several areas in the Draft Guidelines where we believe the ACCC could provide further guidance and clarity. Our comments are set out in the Attachment.

Please contact us if you have any questions or would like to discuss this submission further.

Yours sincerely



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ATTACHMENT

1. Use of simplified examples to illustrate principles

The ACCC states that the examples included in the Guidelines are simplified, high level examples to illustrate particular principles.¹ The ACCC also recognises that the examples provided do not reflect the complexities of real-world practices in the electricity industry.²

CS Energy supports the principle approach taken by the ACCC. It is however vital to industry participants that they obtain clarity in the interpretation of the conduct prohibitions; being too overly simple in the examples will lessen the guidance participants will take from the guidelines. CS Energy considers the ACCC could provide a greater level of complexity in the examples to draw out the nuances in real-world practices. This would provide greater guidance and clarity to industry.

CS Energy has set out below several examples from the Draft Guidelines which we consider would benefit from a greater level of detail.

(a) **Example 4: Individual cost reductions**

The scenario in Example 4 provides that Retailer A can secure a particularly cost-effective hedging contract (due to the load shape of the customer portfolio). As there has not been a substantial and sustained reduction in broader market-wide prices, Retailer A is not required to make a price adjustment to comply with section 153E.

It is assumed because of the reference to “hedging contract” that the pricing is obtained through a hedging contract with a third party. CS Energy considers this individual cost reduction principle should equally apply to gentailers, and pricing obtained through an internal transfer price. We think greater clarity would be provided if the example included a second scenario where Retailer A is a gentailer (Gentailer A) who secured a particularly cost effective internal transfer price (due to the load shape of the customer portfolio). In this second scenario, Gentailer A is also not required to make a price adjustment to comply with section 153E, as there has not been a substantial and sustained reduction in broader market-wide prices.

(b) **Example 11: Reasonable adjustments for different retail products**

The scenario in Example 11 provides that Retailer A offers two products, green contracts (backed by purchasing renewable energy certificates) and a standard electricity contract (for which it does not purchase renewable certificates). The cost of renewable certificates undergoes a sustained and substantial reduction and Retailer A makes a pricing adjustment to its green contract only. It is stated that Retailer A has made the required adjustments.

This example is intended to demonstrate the principle that different retail products can have different underlying costs, therefore the “reasonable adjustment”

¹ Draft Guidelines, page 2

² Draft Guidelines, page 2

required will vary. However, all electricity consumption has a RET liability attached to it (including consumption under a standard electricity contract) for which the retailer will be required to surrender renewable certificates. This cost forms part of the cost stack for each of type of contract in this example.

We consider greater clarity would be provided if Example 11 clearly stated it does not address the reduction in environmental costs to the retailer in meeting its RET liability. Alternatively, the example could provide that while both green contracts and standard electricity contracts have had a reduction in the underlying costs, the cost reduction for green contracts is greater and therefore Retailer A's green contracts will have a greater reduction in price.

(c) **Example 14: Reasonable adjustments do not expect retailers to operate at a loss**

The scenario in Example 14 compares the obligation on two retailers with different levels of profitability to pass through a sustained and substantial reduction in network costs. The principle in Example 14 suggests that the ACCC does not expect retailers to operate at a loss.

CS Energy would appreciate greater clarity from the ACCC on its position with respect to a retailer offsetting internal cost components. At paragraph 2.31, the ACCC states "*if reductions in one cost component are offset by increased costs for another component, this might also influence the extent to which a retailer will be obliged to reduce its prices*". The Draft Guidelines do not address offsetting cost increases for retail costs (which is a cost component for which retailers are not required to make a price adjustment, as per Example 5) against cost reductions for cost components that make up the "underlying cost of procuring electricity".

CS Energy would appreciate additional guidance from the ACCC under the scenario where at the time of a price reset, the retailer:

- makes a downward adjustment to the price of its market offers because of a sustained and substantial reduction in the underlying cost of procuring electricity (eg a recent network determination resulted in a decrease in network costs); and
- makes an upward adjustment to the price of its market offers because of a significant increase in retail costs (eg the development of a new billing system to implement a Rule change).

CS Energy submits in this scenario the retailer has complied with section 153E.

(d) **Examples 18, 20 and 22: Conduct for the purpose of substantially lessening competition**

In the scenarios provided in each of these examples, the ACCC states that Gentailer A had a purpose of substantially lessening competition. As this is the critical test of the financial contracts prohibition, simply stating that the gentailer had this purpose provides little clarity to industry.

We think additional guidance could be provided. For example, in Example 18, while Gentailer A does identify Cut Price Power as a serious competitive threat,

what if the price it offers is simply reflective of Cut Price Power being a new entrant into the market and therefore includes risk premiums for credit and settlement exposure, and potentially is priced differently because there will be a much lower volume purchased by Cut Price Power at the outset. The price therefore is higher, which Cut Price Power views as uncompetitive. Cut Price Power does not contract with Gentailer A, but ultimately secures a hedge contract from another market participant. In this scenario, is there “purpose” simply because Cut Price Power is a competitive threat, has the ACCC inferred purpose, or are there other factors not alluded to in the example that establish the required purpose?

2. Application of the electricity financial contract liquidity conduct prohibition

Section 153F is aimed at ensuring generators do not refuse to offer derivative contracts for anti-competitive purposes. The ACCC states at paragraph 3.7 of the Draft Guidelines that section 153F does not exclude any types of counterparties to electricity financial contract contracts from the prohibition.

CS Energy agrees that if a literal approach is given to the interpretation of this provision any counterparty to a derivative contract is captured. This would include electricity sale agreements with large C&I customers that include bespoke pricing mechanisms in the form of a derivative contract.

Alternatively, if a purposive approach is adopted, CS Energy submits the provision can be interpreted as applying only to derivative contracts between registered market participants. This interpretation is supported by the commentary (and examples) in the Explanatory Memorandum³.

In setting out its approach to the interpretation of the conduct prohibitions, the ACCC has referred extensively to the Explanatory Memorandum to provide guidance. It would be consistent for the ACCC to also seek guidance from the Explanatory Memorandum in its approach on section 153F and the type of counterparty captured by the prohibition.

CS Energy acknowledges the ACCC’s comments in the Draft Guidelines that its focus will be on conduct relating to retailer counterparties.⁴ CS Energy would however encourage the ACCC to resolve this concern and provide certainty to industry that section 153F will be limited in its application to the offering of financial contracts to market participants.

3. Spot market conduct prohibition

3.1. Further guidance on targeted conduct

Sections 153G and 153H are aimed at preventing generators from engaging in conduct in the spot market that undermines the effective operation of the spot market.

The scenarios set out in Example 23 and Examples 30 both involve the generator failing to rebid when it became aware of a change in circumstances and instead

³ Revised Explanatory Memorandum to the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019, paragraphs 2.48 – 2.76

⁴ Draft Guidelines, paragraph 3.7

delayed placing its rebid until immediately prior to the relevant dispatch interval (which is some hours later in each of the examples).

In Example 31, the scenario involves the generator submitting a bid that a unit is unavailable for a technical issue, when this is not actually the case.

As the ACCC is aware, the conduct in each of these examples would be a breach of civil penalty provisions under the National Electricity Rules (**NER**). For example, clause 3.8.22A of the NER (the rebidding civil penalty provision) requires generators to place a rebid as soon as practicable after the generator becomes aware of the change in material conditions and circumstances on the basis of which it decides to vary its bid. In respect of this provision, we note the AER has not sought to enforce this formulation of the bidding rule in any public proceedings since its introduction, and the ACCC did not identify any bids or offers of concerns with respect to the type of conduct alluded to in the Examples in the Retail Electricity Prices Inquiry.

CS Energy acknowledges the ACCC's approach in the formulation of the Draft Guidelines is to provide simplistic examples to illustrate principles. However, where the examples provided are not reflective of existing conduct in the market, they provide little guidance to participants. CS Energy considers the ACCC would provide greater guidance to participants if it could identify conduct that is occurring in the industry that would be captured by the spot market conduct prohibition but that is not also captured by the existing civil penalty provisions under the NER. As we have already stated, CS Energy considers conduct captured by the civil penalty provisions is not prevalent in the market, as the AER would otherwise have issued infringement notices or commenced enforcement proceedings.

3.2. Overlap with the NER

The ACCC states in the Draft Guidelines that it considers section 153G(b)(i) and clause 3.8.22A of the NER are concerned with similar behaviour.⁵ However, the ACCC further states that the Part XICA prohibitions differ from the NER provision, and conduct that the ACCC considers to be in breach of section 153G and section 153H may not contravene clause 3.8.22A of the NER.⁶

CS Energy agrees that the language used in the formulation of the prohibitions differ. However, it is difficult to envisage a real-world practical example of conduct that would breach section 153G and section 153H that would not also breach clause 3.8.22A of the NER.

CS Energy encourages the ACCC to provide as much certainty as it can in its approach to the interpretation of the conduct prohibitions. In light of the overlap with the NER it is not clear what conduct is intended to be targeted by the spot market conduct prohibition, which leaves it unclear how to practically instruct spot traders to comply with the conduct prohibitions. If the ACCC cannot think of a practical real-world example of conduct that would breach section 153G and section 153H that would not also breach clause 3.8.22A of the NER, CS Energy encourages the ACCC to state this in the final guidelines.

⁵ Draft Guidelines, paragraph 4.15

⁶ Draft Guidelines, paragraph 4.16