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Australian Competition & Consumer Commission
MELBOURNE VIC 3000
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ACCC guidelines on the Prohibiting Energy Market Misconduct Act

CS Energy welcomes the opportunity to provide a submission to the Australian Competition and Consumer Commission (**ACCC**) on its approach to the interpretation and enforcement of guidelines (**Guidelines**) in respect of the three new 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.

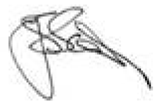
General comments

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. During passage of the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019* (**PEMM Bill**), industry provided extensive feedback to the Government and the Senate Economics Legislation Committee (**Senate Committee**) that the PEMM Bill, if introduced, would create vague and uncertain obligations as to whether behaviour is or is not prohibited conduct. Extensive feedback was also provided on industries' concerns with the application of the proposed sector specific remedies. Although this feedback included detailed recommendations to improve the drafting of the PEMM Bill, industries concerns were not addressed and the PEMM Bill was enacted with minor amendments only. The Senate Committee in its Report on the PEMM Bill took a similar approach and instead of seeking to improve the drafting of the PEMM Bill, expressed the view that the uncertainty around definitions and the operation of the legislation would be resolved by the ACCC in the Guidelines.[1]

Obtaining clarity in the interpretation and enforcement of the PEMM Act is vital to delivering confidence to electricity industry participants as to how to interpret and apply the law. The Guidelines are now key to delivering this clarity and CS Energy asks the ACCC to provide this clarity to participants.

Our detailed submission on the ACCC's approach to the interpretation and enforcement of the Guidelines is set out in the Attachment. Included in our detailed submission are examples of conduct that, CS Energy submits, do not contravene the conduct prohibitions.

Yours sincerely



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[1] The Senate Economics Legislation Committee Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 [Provisions], Report, p86

ATTACHMENT

1. Overarching principles

CS Energy believes the ACCC should apply several overarching principles to its approach to the interpretation and enforcement of the conduct prohibitions.

The fundamental principle which must be applied is that the conduct prohibitions will be interpreted consistent with the design and intended operation of the NEM. The National Electricity Objective, as set out in the National Electricity Law (**NEL**), is to promote efficient investment in and efficient operation and use of electricity services for the long-term interests of consumers. Regulators chose a market model as the basis for meeting this objective. The NEM design, as established under the NEL and National Electricity Rules (**NER**) is an energy only market[2], with generators being paid only for energy delivered to the market. Bidding of capacity at various price bands ensures the most efficient generators are dispatched to meet demand, and enables participants to recover their marginal costs (effectively the fuel cost). If a tightening of supply and demand occurs, scarcity pricing enables generators to recover capital costs as well as delivering signals that new investment is required. Behaviour contemplated by the market design must be taken into consideration when considering if there is a contravention of the conduct prohibitions. Behaviour that has been contemplated by the market design should not be considered a contravention.

CS Energy also considers the conduct prohibitions must be interpreted in the broader context of the myriad of complex regulatory obligations electricity entities operate within. The Guidelines should include a clear overarching principle that action taken by an electricity company in compliance with these regulatory obligations will not be considered a contravention of the conduct prohibitions. This is particularly relevant given the ability to infer "purpose" to action that is the subject of the conduct prohibitions. Participants are typically complying with several regulatory obligations in actions taken, and an anti-competitive purpose or intent to distort or manipulate prices should not be inferred in these circumstances. Relevantly, a company should not be taken to have breached the conduct prohibitions in respect of actions taken:

(a) to ensure the safety of persons and property;

(b) to ensure the secure and reliable operation of its plant and equipment;

(c) to comply with environmental obligations;

(d) to ensure the corporation remains financially viable including actions taken to manage prudential requirements and credit risk; and

(e) by its directors to discharge their duty to act in the best interests of the company.

CS Energy considers the Guidelines should also provide more sophisticated examples of conduct that would or would not be a breach of the conduct prohibitions. The examples provided in the explanatory memorandum to the PEMM Bill were overly simplistic, and the conduct in question was either an obvious contravention of the conduct prohibitions or did not amount to a contravention. CS Energy acknowledges that this is a challenging task, however simplistic examples do little to assist participants in obtaining clarity in the interpretation and enforcement of the conduct prohibitions.

2 There are also eight frequency control ancillary spot markets.

2. Prohibited conduct - Retail pricing (section 153E)

CS Energy is a member of the Australian Energy Council (**AEC**) and supports the comments made by the AEC in its submission on section 153E of the CCA, including its comments on the key terms in section 153E of the CCA.

As CS Energy is not a mass market retailer (we do not retail directly to small customers but participate in the South-East Queensland retail market through our joint venture with Alinta Energy), we do not propose making any further comments on this prohibition.

3. Prohibited conduct - Electricity financial contract liquidity (section 153F)

Section 153F is aimed at ensuring generators (with a focus on gentailers) do not refuse to offer derivative contracts for anti-competitive purposes.

3.1. Extent of application

CS Energy understands the purpose of this prohibition is to ensure electricity retailers can seek derivative contracts to manage the risk of spot price volatility in the wholesale market. This is consistent with the commentary (and examples) in the explanatory memorandum. Section 153F is however drafted widely and could be given a broader interpretation than that suggested in the explanatory memorandum.

It is not clear from the drafting of section 153F if this prohibition is intended to extend to contracts with large C&I customers who use bespoke sophisticated pricing mechanisms for their electricity procurement. It is becoming frequently common for these pricing mechanisms to be in the form of a derivative contract. The explanatory memorandum does not however make a single reference to this prohibition applying to large C&I customers.

If section 153F is given a broad interpretation, it is open to a large C&I customer that is unable to reach contractual agreement on full commercial terms to assert a breach of the conduct prohibitions. CS Energy considers the Guidelines should clarify that section 153F is limited in its application to the offering of financial contracts to electricity retailers. This interpretation is consistent with the wording of the explanatory memorandum.

3.2. Key concepts

The text used in the drafting of section 153F includes the following concepts:

(a) “fails to offer”;

(b) “limits or restricts its offers”; and

(c) “preventing, limiting or restricting acceptance of those offers”.

CS Energy is of the view that the ACCC should not seek to define these concepts in the Guidelines and these concepts should be given their ordinary meaning. We believe this element of the section 153F conduct prohibition will not be difficult to establish using the plain and ordinary meaning of these concepts. Attempting to define these concepts may create greater uncertainty as to their application. This is because we see the critical test in section 153F is that the conduct is done for the purpose of substantially lessening competition.

We suggest clarity could be provided by including in the Guidelines examples of conduct that, whilst satisfying the elements in section 153F(b), would not be prohibited conduct as there was no underlying anti-competitive purpose. Set out below are examples of such conduct.

Example 1

Generator A holds a portfolio of generation assets supplying 10% of the NEM's demand. With extreme prolonged high temperatures forecast for Q1 2022, Generator A considers the likely derating of its thermal plant during this period. With the possibility of lower available capacity, Generator A adopts more conservative limits for its contract book. The revised contracting limits results in Generator A holding a full "hedge" book for Q1 2022. Consequently, Generator A stops offering ASX contracts and OTC products for Q1 2022. Retailer X is a small retailer and typically mitigates its spot price exposure with OTC products entered into with Generator A. Retailer X sees a significant increase in its retail portfolio for 2022 and seeks to contract with Generator A to cover its increased exposure to spot prices. However, as Generator A has stopped offering contracts for Q1 2022 due to the reduction in its contracting limits, Retailer X is unable to obtain its required coverage through Generator A for Q1 2022.

Example 2

Generator B holds a portfolio of generation assets and retail customers (mass market and C&I). Retailer Y is seeking to enter the electricity market and is negotiating an ISDA agreement with Generator B. Generator B's retail arm will be in competition with Retailer Y. Generator B initially required the credit support annex under the ISDA master agreement to apply to the arrangements. As a new entrant to the market, Retailer Y was concerned that it would not have the cash flow requirements to be able to meet the mark-to-market obligations and instead offered security in the form of a bank guarantee for an agreed sum. While Generator B was willing to accept security in this form, it placed a higher risk premium on this form of security which would be reflected by way of a material increase to the fixed price under any transaction entered into between the parties. Further, as Retailer Y did not yet have a credit rating, the risk premium was higher than that applied to other counterparties. Retailer Y decided not to accept the terms offered by Generator B because of the higher fixed price.

Example 3

Generator C owns two scheduled generators and is active in the OTC market. Retailer Z is a small boutique retailer seeking a load following swap for a small volume (on average 2MW). Generator C's internal credit policy does not prohibit Generator C from contracting with Retailer Z, however the 2MW contract volume being sought by Retailer Z is below the volume ordinarily contracted by Generator C. Generator C considers the administrative costs associated with such a small contract volume outweigh the benefits. Generator C decides it will not make an offer to contract with Retailer Z.

Under each of these examples, the concepts in section 153F(b) are clear to establish. In examples 1 and 3 there is a failure to offer and in example 2 the terms of the offer prevented acceptance of the offer. However, the conduct in question would not constitute a contravention of section 153H as the conduct was not engaged in for the purpose of substantially lessening competition. In example 1, the conduct resulted from action taken by Generator A to mitigate its financial exposure due to the reduced capacity of its plant. In example 2, the conduct was engaged in to ensure Generator B managed its credit risk exposure consistent with its risk appetite. In example 3, the contract is for a structured product and the volume sought is too low for the contract to be economic for Generator C.

The commercial and operational factors underlying whether Generators may or may not offer financial contracts, or if offered the terms on which those contracts are offered, are wide-ranging. We encourage the ACCC to clarify in the Guidelines that legitimate commercial and operational decisions should not be considered a contravention of the conduct prohibition.

4. Prohibited conduct - Electricity spot market (sections 153G and 153H)

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.

4.1. "Fraudulently, dishonestly or in bad faith"

Sections 153G and 153H prohibits generators from acting "fraudulently, dishonestly or in bad faith" when making bids or offers in the spot market.

Overlap with the NER

This is a clear overlap with section 3.8.22A of the NER, which prohibits a market participant from making an offer, bid or rebid that is false, misleading or likely to mislead.

In CS Energy's view, these two prohibitions seek to regulate the same conduct. It is not clear it if is intended that different standards of conduct apply under the two prohibitions. If guidance is not provided, it will be extraordinarily confusing for market participants to comply with.

The Guidelines must clarify how these two provisions are intended to operate together. Relevantly:

(a) while the language used in each of the prohibitions is different, does the ACCC consider that they are intended to capture the same conduct;
(b) if not, the Guidelines must clarify conduct which would be captured under the conduct prohibitions but which is not a contravention of the NER; and
(c) if the ACCC considers that the prohibitions are intended to capture the same conduct and proceedings can be bought by the Australian Energy Regulator under the NER, in what circumstances would the ACCC take action?

Meaning of key concepts

CS Energy does not believe the ACCC should seek to define the concepts "fraudulently, dishonestly or in bad faith". These concepts are already subject to significant judicial consideration, for which the judicial opinion is conflicting. Instead of seeking to provide definitions for these concepts, we encourage the ACCC to include in the Guidelines detailed guidance (including through use of examples) on what behaviour it considers is targeted by this conduct prohibition.

4.2. Behaviour that distorts or manipulates market prices

The words "distort" and "manipulate" are capable of several meanings. Within the context of an energy only market, each bid or rebid could arguably be said to distort or manipulate market prices if given the appropriate meaning. It is clear from the explanatory memorandum that this was not intended, however the simplicity of the examples provided offer little guidance as to the actual conduct targeted. It has been left to the Guidelines to clarify what behaviour is intended to be targeted by this prohibition.

While the design features of an energy only market design is acknowledged in the explanatory memorandum, the commentary predominantly focuses on this being a mechanism to signal new investment. The market design also provides a mechanism for existing participants to recover their capital costs. It is also intended that recent changes to the NEM market design will drive greater efficiency in operational and investment decisions. The implementation of 5-minute settlement in July 2022 is anticipated to result in behaviour more responsive to underlying supply-demand conditions over the shortest possible timeframe, being the 5-minute trading interval.

The market design is premised on the principle that individual participants will bid and rebid capacity into the market to take advantage of the conditions on that day. These decisions are made minute by minute, reflective of a host of underlying factors at the time the bid or rebid is made. When periods of tight demand and supply emerge, most generators will bid or rebid a proportion of their capacity at higher price bands to take advantage of the tight supply and demand conditions. These periods allow generators to recover capital costs, which are not typically recovered during periods of low or moderate demand when generators bid to recover marginal costs. The behaviour is not limited to peaking plants (as suggested by the explanatory memorandum[3]) but also a characteristic of base-load generation which will rebid some of its capacity to higher price bands to recover capital costs.

Example 4

To manage unplanned generation and network changes, dispatch instructions to generation result in counter price flows from Victoria to New South Wales to ensure the New South Wales-Victoria interconnector remains in a secure operating mode. This results in an un-forecasted tightening of demand and supply in Victoria, initially as a Lack of Reserve (**LOR**) 1 escalating to a LOR 2. Gen Baseload decides to respond to the tightening in the demand and supply (due to the change to market and power system conditions) to recover capital costs and rebids 100MW of capacity at the market price cap (**MPC**). Gen Baseload is the marginal generator for two dispatch intervals, setting the price for these dispatch intervals at the MPC. Following the change in market conditions, additional peaking plant responds and Gen Baseload's 100MW of capacity which has been bid at the price cap is no longer dispatched into the market. Gen Baseload's rebids are compliant with the NER.

While Gen Baseload has set the price for two dispatch intervals, this conduct is contemplated by the market design and is not a contravention of the conduct prohibitions.

The market has also been designed so that participants can recover their efficient marginal costs. The market operates to stack generators' bids in order of rising price, with the intention being more efficient generators are dispatched over less efficient generators, to determine which generators are required to satisfy demand. Less efficient generators may temporarily or permanently exit the market as underlying fuel costs vary and generators are unable recover these costs.

[3] PEMM Bill, Revised Explanatory Memorandum, paragraph 2.100

Example 5

The growth in wind, large-scale solar generation and rooftop solar PV has led to historically low (including negative) pricing during the day than what has been seen previously. Gen Coal has previously offered its capacity at prices below $0 for its minimum load with other volume priced at or above its marginal cost. During the spring and autumn months capacity offered at (or above) its marginal cost is frequently not being dispatched during the middle of the day (as prices are low or negative). As Gen Coal is not able to recover its marginal costs on generation dispatched, it is becoming uneconomic for Gen Coal to continuously run all of its units. Gen Coal decides to change it bidding strategy for this period and decommits a unit during periods of forecast high renewable generation. All bids are compliant with the NER. Due to this change in bidding strategy, its remaining capacity which is offered for dispatch is typically dispatched during the day at prices bid at its marginal cost.

A major outage occurs on the Central Queensland – Southern Queensland (**CQ**-**SQ**) grid which will significantly reduce the capacity on this transmission line in August whilst repairs are carried out. The ability of large-scale solar generation located in central and northern Queensland to supply demand in South-East Queensland during the day is also reduced. Due to the change in the underlying supply-demand balance, Gen Coal changes its bidding strategy during the outage period and bids the capacity of the previously decommitted unit into the market.

Gen Coal's bidding strategy has impacted market prices. These decisions are however consistent with the market design, which contemplated participants being able to recover their efficient marginal costs.

Meaning of key concepts

While the concepts "distorting" and "manipulating" are capable of definition, any definition must be in the context of the market design within which participants operate. Various factors underpin bidding strategies and consequently individual bids and rebids. Instead of seeking to provide definitions for these concepts, we again encourage the ACCC to include in the Guidelines (including by way of examples) detailed guidance on what behaviour it considers is targeted by the prohibition of "distorting or manipulating market prices".

5. Processes

The PEMM Act introduces over-reaching industry specific remedies, with unprecedented powers conferred on the ACCC and the Treasurer with little judicial oversight.

Part 2 of the AEC's submission (titled "ACCC processes and approach to investigations") provides detailed comments on the processes and remedies established under the PEMM Act. CS Energy supports the comments made by the AEC in its submission on these issues.