Delta electricity

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Guidelines on the Prohibiting Energy Market Misconduct Bill – Issues for consultation

Delta Electricity welcomes the opportunity to make a submission to the Australian Competition and Consumer Commission (ACCC) regarding the Guidelines on the Prohibiting Energy Market Misconduct (PEMM) Bill. Delta owns and operates the 1,320MW Vales Point power station in NSW and has a retail licence to sell electricity to large customers. Delta has operated coal and gas fired generating plant in the National Electricity Market (NEM) since its start in 1998 and is an active participant in both the electricity and gas trading markets.

Delta Electricity is concerned about the concepts introduced by the PEMM Bill and its proposed processes and remedies which could lead to unintended consequences. These concerns are articulated below.

Prohibited conduct type 1: Retail Pricing

The prohibited conduct is a failure to make reasonable adjustments to the price of supplies (or offers to supply) to reflect sustained and substantial reductions in the corporation's cost of procuring electricity.

In relation to prohibited conduct type 1: Retail Pricing, the ACCC has requested stakeholder input on the appropriate interpretation of the following terms:-

"reasonable adjustments";

"sustained and substantial"; and

"underlying cost of procuring electricity"

Whether a reduction in the underlying cost of procuring electricity will be sustained into the future may be difficult to determine for some inputs. This is because some of the underlying cost structures, particularly those associated with vertically integrated generation portfolios, span across multiple years.

Quantifying "substantial" is likely to result in a different outcome for each organisation depending on the size, scale and complexity of its retail operation. Therefore, the guidelines should consider a methodology for quantifying "substantial" that is able to be equitably applied across different sized retail operations.

In determining the underlying cost of procuring electricity, Delta recommends the guidelines consider the costs for retailers associated with the risks in managing the retail customer load shape and variability within its portfolio. This is because the actual electricity load shape and volume consumed by small customers will inevitability differ from the retailer's portfolio hedge position, leaving the retailer with some residual exposure to spot.

Prohibited conduct type 2: Electricity financial contract liquidity

In relation to electricity financial contract liquidity, the purpose of the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 (Bill) is to ensure that corporations that generate electricity do not undertake conduct for the purpose of substantially lessening competition in any market.

Whilst the purpose of the Bill is already established and effectively delivered through the existing Competition and Consumer Act 2010 (CCA), the new Bill clarifies prohibited conduct to be where a corporation that generates electricity:

- fails to offer electricity financial contracts;

- limits or restricts its offers to enter into electricity financial contracts; or

- offers to enter into electricity financial contracts in a way that has the effect (or likely) effect of preventing, limiting or restricting acceptance of those offers and it does so for the purpose of substantially lessening competition in any market.

Key Concepts

ACCC guidelines in support of the Bill should include consideration of issues identified below regarding the use of financial contracts in the context of the electricity bilateral 'over the counter' (OTC) and also exchange traded (electricity futures) markets, both of which are relevant to section 153C of the CCA.

A corporation that generates electricity does not have the ability to offer an unlimited volume of financial contracts. The commercial reality of funding capability for a corporation to manage settlement payments that accommodate potential upward and downward spot market price movements will ultimately limit the volume and type of financial contracts that can be supported. Settlement payment obligations for the corporation must also adhere to the electricity market's weekly settlement payment timeframes necessitating careful and structured commercial funding arrangements.

Settlement payments for electricity market financial contracts fundamentally involve difference payments between a contract price and a market reference price (the relevant regional spot prices) with a corporation being reliant on their payment for actual generation by the market operator (AEMO) to enable it to fund difference payments to settle electricity financial contracts.

The number of electricity financial contracts that can be supported by a corporation is therefore limited and should also be expected to be consistent with its ability to access expected spot price settlement payments from its electricity generation assets for a particular contract time period. The ability to place electricity financial contracts is also constrained by the demand from the market for those financial contracts in that same contract time period.

Examples of factors affecting the volume of contracts able to be supported by a corporation and the type of electricity financial contracts that may be offered to the market include but are not limited to the following:

- the location (NEM region) of generation assets;
- the number of generating units;
- the size of each generating unit and the size of each generating unit relative to the total generating assets held by the corporation in a region;
- the reliability of each generation plant;
- planned generating unit outages;
- the type of generation plant;
- hours of operation or intermittency (for example solar generation or wind);
- limitations on the fuel or other environmental factors or other licences that may otherwise limit generation;
- the volume of internal contacting required in support of retail sales in the case where a corporation is vertically integrated (gentailer);
- financial contract type: exchange traded futures or OTC contract;
- transaction cost and funding requirements of exchange traded contracts;
- counterparty credit risk; and
- a commercial assessment of contracting expected generation against the alternative spot market outcome.

As the ACCC guidelines are intended to clarify the types of conduct and circumstances likely to cause the ACCC concern in relation to the CCA and the types of conduct and circumstances that are unlikely to cause the ACCC concern, it is important that the guidelines recognise a corporation's normal commercial risk management practice when dealing with electricity financial contracts. ACCC guidelines should therefore articulate that a corporation's business as usual commercial operation of its generation plant assets (addressing the above factors) and management of market risk within its funding capability provides an expectation of a limit to the volume and type of electricity financial contracting undertaken.

Prudent commercial terms are applicable when making offers of OTC electricity financial contracts to the market, including acceptable counterparty credit worthiness or a requirement for credit support enhancement as well as a validity term for an offer. These terms allow a generator the ability of offer financial contracts relevant to current market prices as well as extending the potential contracting term to many years. Such terms are not representative of a restriction of acceptance of an offer but instead ensure financial contracts are established on a sound commercial standing and within a reasonable timeframe.

In the case of a corporation with generation receiving requests from multiple market participants for a financial contract in respect of the same nominated large customer (for example a large industrial customer who has tendered their electricity requirement), the corporation may require that the market participant win the customer in order to accept the electricity financial contract offer. This promotes competition as it enables the corporation with generation to make financial contract offers to more than one market participant in respect of the same generation capability in the knowledge that only one offer may be accepted (by the successful market participant who wins the large customer).

A key insight that should be provided by the guidelines is the ACCC's view or examples of behavior or circumstances where prohibited conduct type 2 may substantially lessen competition in any electricity market.

Processes and Remedies

A consultative approach has been introduced with clear timeframe expectations that provides the ACCC with a 21 day window in which to engage with a corporation in regard to past or current prohibited conduct prior to further escalation measures via a draft public warning notice or public warning notice and ultimately infringement notices or contracting order or divestiture order where applicable. A corporation appropriately has the opportunity to respond to the ACCC within the window and prior to public notices.

To ensure that a corporation can comprehensively respond to issues identified in a notice issued by the ACCC within the 21 day window the ACCC should include in its guidelines all relevant ACCC contacts and approved communication channel details for use by a corporation should it be required to respond to relevant notices from the ACCC.

Prohibited conduct type 3: Electricity spot market (basic case) - Fraudulently, dishonestly or in bad faith

Key concepts:

The National Electricity Rules (the Rules) under section 3.8.22A prohibits offers, bids and rebids that are false, misleading or likely to mislead.

The concepts from the PEMM Act, namely fraudulently, dishonestly or in bad faith, are not materially dissimilar, nor do they supplement those described in the current electricity law and rules. It is very important for ACCC to clarify these concepts when developing the guidelines.

<u>Processes and Remedies</u>

The AER issued “Rebidding and Technical Parameters Guideline” for market generators to follow in February 2017. The guideline is currently used by the AER to monitor generator behavior and enforce compliance of the Rules. The ACCC in its guidelines should avoid overlapping regulations with the AER for the same purposes. The scope and terms of reference should be well defined to avoid confusion. The level of enforcement between the ACCC and the AER should be clear cut. Information required by the two regulators should not be duplicated.

<u>Examples of conduct that is unlikely to breach the prohibitions</u>

1. Offers and rebids in response to unforeseen plant condition and operating licence compliance.

   Offers and rebids normally reflect physical availability of generating plants. Rebids are often triggered by unexpected change of physical plant conditions. A sudden loss of available capacity in one generating unit likely to cause rebid to adjustment loads on other generating units of the portfolio. Generators in compliance of their operating licence may subject to regulations over operating conditions such as environmental protection regulations. Generation capacity may be limited for environmental concerns.

2. Generation optimisation

   Optimisation is the nature of business operations as generators are given limited resources to compete in the NEM. Generators may offer or re-offer capacity to higher prices when there are opportunities of tight supply to the market. This is considered as transitory and is the feature of energy only NEM design. Transitory is recognised by the revised explanatory memorandum of the PEMM Bill.

   The price of frequency control ancillary services (FCAS) market can significantly diverge from the energy market. Generators who participate on both the FCAS and energy markets often make offers and re-offers to optimise across both markets.

3. Managing Market events

   The electricity market is dynamic and complex. Demand and prices generally fluctuate due to sudden changes in weather conditions as well as unforeseeable physical limitations such as network strength and transmission network constraints.

   The frequency of intervention pricing imposed by the Australian Energy Market Operator (the AEMO) is increasing as generation from renewable energy increases. Intervention pricing distorts price signals as trading price and dispatch price are separated. Generators may need to constantly readjust bids to reflect intended generation.

Transmission line constraints alter energy flows that could affect a generator’s production. Line constraint could also lead to unexpected price fluctuation that could trigger generators to rebid to readjust their position in the marketplace.

Prohibited conduct type 4: Electricity spot market (aggravated case) - Distorting or manipulating prices

Delta Electricity would encourage ACCC to provide clear and unambiguous definitions of distorting and manipulating prices in the guidelines.

Yours sincerely,

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