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Monday, 6 January 2020

Lyn Camilleri
General Manager, Electricity Markets Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

Dear Ms Camilleri

RE: Guidelines on the Prohibiting Energy Market Misconduct Bill

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Competition and Consumer Commission's (ACCC) guidelines on the Prohibiting Energy Market Misconduct Bill ("the Bill").

About ERM Power

ERM Power (ERM) is a subsidiary of Shell Energy Australia Pty Ltd (Shell Energy). ERM is one of Australia's leading commercial and industrial electricity retailers, providing large businesses with end to end energy management, from electricity retailing to integrated solutions that improve energy productivity. Market-leading customer satisfaction has fuelled ERM Power's growth, and today the Company is the second largest electricity provider to commercial businesses and industrials in Australia by load[1]. ERM also operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, supporting the industry's transition to renewables.

https://ermpower.com.au/

https://www.shell.com.au/business-customers/shell-energy-australia.html

General comments

ERM Power understands the rationale for the Prohibiting Electricity Market Misconduct Bill and shares the Government's desire to bring down electricity prices, preserve or enhance competition, ensure there is a deep and liquid contract market and avoid conduct which undermines the effective operation of the wholesale market. We consider that the development of fit-for-purpose guidelines is a critical part of this Bill to ensure that the Bill works as intended and does not create unintended consequences or perverse outcomes. We also note that some activities prohibited by the Bill would also be prohibited by other means such as the use of the Default Market Offer (or Victorian Default Offer) and existing clauses of the National Electricity Rules (NER).

Prohibited conduct in the retail electricity market

We acknowledge that the Bill applies restrictions on retail offers to small customers (consumption of less than 100 MWh per annum). We believe this is a prudent decision as arrangements for commercial and industrial (C&I) customers are very different to those for small customers. The ACCC's Retail Electricity Pricing Inquiry found that

[1] Based on ERM Power analysis of latest published financial information.

C&I customers paid lower prices for electricity due to lower network costs, retail costs and margins, compared to small customers.[2]

The ACCC seeks input on a range of terms including the “underlying cost of procuring electricity”. We contend that the underlying cost of procuring electricity should reflect the various components of a retail bill. Electricity prices for all customers – small or large – are made up of a series of different costs including wholesale electricity costs (which are generally hedged using the contract market), network tariffs, environmental charges and retail costs. We note that the Bill’s explanatory memorandum does not consider retail costs to be part of the costs of procuring electricity.[3]

ERM Power challenges this assertion, as many retail costs are directly related to being able to sell electricity to small customers. These costs include licensing requirements, audits, hardship programs and meeting other compliance requirements, including significant system changes to support new market reforms. For small retailers, these costs can make up a higher proportion of their cost stack compared to large retailers with high customer numbers. Excluding these retail costs from the “underlying cost of procuring electricity” would tend to advantage large retailers, especially vertically-integrated gentailers, who have greater economies of scale. This could then negatively impact retail market competition, making it far harder for small and new entrant retailers to compete with established retailers. Therefore, we recommend that the ACCC include retail costs in its definition of “underlying cost of procuring electricity”.

This approach would be consistent with the Australian Energy Regulator’s (AER) approach to setting the default market offer. Under clause 16 of the Competition and Consumer (Industry Code—Electricity Retail) Regulations 2019, the AER must have regard to “the cost of serving small customers” as part of determining annual prices.

Further, it will be problematic for the ACCC to readily define the terms “reasonable adjustments” and "sustained and substantial". “Reasonable” is an entirely subjective term and will differ according to the arrangements of each retailer. Due to the nature of settlement in the spot market, retailers are exposed to different pricing arrangements every 30 minutes (reducing to 5 minutes from 1 July 2021). While hedging these risks using financial contracts can reduce the risk exposure, there may be some periods where they are exposed to high prices for particular trading intervals, at which time they may make a loss, and other times where they may profit. A retailer will therefore price its customers at an appropriate level to balance these risks.

Additionally, a retailer’s hedging practices will have an influence on their ability to adjust prices following a fall in wholesale prices (or environmental scheme costs). Some retailers may have long-term contracts in place at higher prices than recent average spot prices and may accordingly be unable to make adjustments to prices in a timely fashion without incurring a loss. Conversely, a retailer with a more dynamic hedging portfolio may be able to adjust prices up or down regularly in order to compete effectively in the market without exposing itself to undue risks.

Finally, a “substantial” saving in one area of underlying costs, may be offset by an increase elsewhere. Changes to network tariffs may offset wholesale price reductions. Or, a change in the customer base’s usage profile, leading to higher usage at times of high prices, could lead to changes to the underlying costs to serve the entire customer base, despite a possible fall in average prices. We recommend the ACCC consider all of these issues as they seek to define the terms “underlying cost of procuring electricity”, “sustained and substantial” and “reasonable adjustments”.

Prohibited conduct – spot market

The issue of distorting the spot market through rebidding is one that has been discussed and investigated at some length over the past few years. The Bidding in Good Faith and Five Minute Settlement rule changes stemmed

[2] ACCC (2018), *Retail Electricity Pricing Inquiry – Final Report*, p 351.
[3] Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019, Explanatory Memorandum, p 15.

directly from the issue of rebidding in the spot market, while the Wholesale Demand Response rule change currently under consideration also relates to some rebidding issues.

Given that this issues has been explored so deeply already, we consider that the ACCC should look to the existing Bidding in Good Faith provisions of the NER to inform itself of the concepts “fraudulently, dishonestly, or in bad faith" and "distorting or manipulating prices". The AEMC consulted intensively with the electricity industry on Bidding in Good Faith provisions and the Final Determination on this rule change contains a wealth of analysis of what issues the AEMC was seeking to address. It would seem unnecessary to relitigate these discussions again and find that there are competing and potentially contradictory requirements on generators when bidding into the NEM.

The Bidding in Good Faith rules establish that generators’ offers are to be a representation to other market participants that the offer or rebid will not be changed unless the generator becomes aware of a change in the material conditions and circumstances upon which the offer or rebid is based. Consequently, to comply with the rules, any rebid made to vary an offer to supply the market needs to be made as soon as practicable after the generator becomes aware of the change in material conditions and circumstances so that the original offer does not become unreflective of the generator’s actual intentions.

Additionally, these rules require rebidding generators to make and keep a contemporaneous record for each rebid made within the late rebidding period. The late rebidding period is defined as beginning 15 minutes before the commencement of the trading interval to which the rebid applies and ending at the end of that trading interval. The record must contain the material conditions and circumstances giving rise to the rebid, the generator's reasons for making the rebid, the time at which the relevant event occurred, and the time at which the generator first became aware of the event.

For compliance purposes, it would be far better for companies and traders to need to comply with one set of rules rather than risk facing inconsistent or conflicting requirements where bidding activity could be compliant with one set of rules but not with another. ERM Power therefore recommends that the PEMM Guidelines mirror the existing Bidding in Good Faith rules (Clauses 3.8.22 and 3.8.22A of the NER) in order to ensure consistency and certainty for the market, while also meeting the aims of the Bill. Should the ACCC determine that a different set of rules or expectation for spot market bidding is necessary then we urge the ACCC to ensure these are aligned with the NER by first requesting a change to the bidding rules through the AEMC.

Electricity financial contract liquidity

Some participants rely heavily on financial contracts in order to manage their exposure to the volatility of the NEM’s spot market. These parties rely on a deep and liquid contract market to manage risks and for price discovery. As such, the potential for economic withholding of contracts from the financial contract market would have a deleterious impact on certain participants.

It may be challenging for the ACCC to determine whether sellers have breached the Bill and to otherwise determine what the ‘right’ volume of contracts for a seller to make available is and how appropriate the terms on which they are available are. Different sellers will have different risk appetites, different exposures in fuel markets, different portfolios to manage and different needs for self-supply. This means that the ACCC may need to reach a view on how each of these factors influence.

Furthermore, changes to wholesale market arrangements such as five minute settlement (commencing on 1 July 2021) and the potential implementation of new pricing arrangements through the Coordination of Generation and Transmission Investment review have the scope to fundamentally shift the volumes and terms of contracts sellers can make available to the market. We consider that it will be extremely difficult to assess whether sellers are breaching the Act.

It was for this reason that ERM Power previously recommended that, in line with Recommendation 7 of the ACCC's Retail Electricity Pricing Inquiry Final Report, there should be an obligation on large vertically-integrated gentailers to make contracts available if contract market liquidity declined below a threshold level. This could act similarly to the Market Liquidity Obligation (MLO) that forms part of the Retailer Reliability Obligation. In our submission to the Energy Security Board's inquiry into Market Making Requirements in the NEM, we proposed a model where, outside of the MLO, a rolling two-year window would be used to assess the need for market making obligations.

The ACCC should look to ensure consistency with other approaches to understanding contract market liquidity, so as not to duplicate existing work, or create inconsistencies in the market. The Australian Energy Market Commission's final determination on the Market Making Arrangements in the NEM rule change recommended that the AER monitor certain contract market liquidity metrics as part of its market monitoring function.[4] ERM Power recommends that the ACCC look to this work rather than to develop a new and possibly conflicting process.

This would provide a clear metric for the need for liquidity and a clear requirement for sellers to meet, rather than penalties based on an opaque assessment.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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[4] AEMC (2019), *Market Making Arrangements in the NEM – Final Determination*, pp 34-37