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Senate Standing Committees on Economics
PO Box 6100
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Canberra ACT 2600

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Inquiry into the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018

Origin Energy Limited (Origin) appreciates the opportunity to provide comments to the Economics Legislation Committee's inquiry into the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018 (Bill)*.

Origin has significant concerns with the Bill, which if enacted, will have a detrimental impact on the efficient functioning of the electricity market. In many aspects, the Bill is unworkable, confusing, discourages investment, is an over-reach into a free market, and a potentially costly burden on taxpayers.

The retail prohibition requiring the mandatory pass through of cost savings in retail tariffs is unworkable and inconsistent with the normal operations of competitive markets. The prohibitions relating to the wholesale and contracts markets duplicate existing rules and would only create confusion and uncertainty for participants, with the potential to constrain legitimate behaviour. The divestiture power is unprecedented and is a disproportionate and punitive response to the potential contraventions outlined in the Bill. Overall, the new measures will increase the risk profile of the energy sector, which will dissuade future investment by the private sector. This will progressively shift the burden to government (ultimately taxpayers) through greater reliance on schemes such as the Commonwealth's recently announced plan to underwrite new generation capacity. This is unlikely to be a sustainable or efficient approach.

While more work is required to improve outcomes for consumers, the Bill is not the answer, nor is it an appropriate substitute for a long-term policy framework

Improvements are needed across the supply chain to deliver better outcomes for consumers and effectively manage the market transition currently underway. Industry must continue to do more to maintain downward pressure on prices by investing in supply and making it easier for consumers to compare retail offers. For our part, Origin has increased output at our Eraring power station following recent generator retirements, and we are progressing work on potential upgrades to our Quarantine and Shoalhaven stations. Despite recent higher wholesale and network prices and environmental scheme costs, we have sought to provide some relief to our customers by holding or reducing retail tariffs across jurisdictions.

A robust regulatory regime is also crucial to a well-functioning market. More needs to be done, including consultation (and implementation where appropriate) on the recommendations from the Australian Competition and Consumer Commission's (ACCC) recent inquiry into the sector. However, it should also be noted that there have been several recent (and pending) regulatory changes aimed at improving key aspects of the market. These include: greater transparency; enhanced customer protections;

making it easier for consumers to exercise choice and compare retail offers; and a notification process for generator closures that will help to minimise future supply disruptions and price shocks.¹ These developments further negate any rationale for enacting the Bill, particularly when considered alongside some of the unintended consequences that are likely to arise.

Where there is a clear gap, is the ongoing absence of a stable, consistent, and predictable policy framework for the energy sector. While the so called 'Big Stick' approach set out in the Bill was first envisioned following the collapse of the National Energy Guarantee, this hastily put together package of prohibitions and remedies is not an appropriate substitute for long term policy planning.

The reasons for our strong opposition to the Bill are outlined below, with additional detail provided in Attachment A.

The retail prohibition (section 153 E) is ambiguous, unprecedented, inconsistent with the functioning of competitive markets, and would prove difficult to administer

- In seeking to prescribe the pass through of cost savings realised by energy companies in retail tariffs, section 153 E is likely to undermine the commercial incentive to strive for efficiency gains. Competitive markets are founded on the premise of participants seeking to attain productive efficient outcomes that will ultimately flow through to consumers in the form of lower prices. Often market participants incur risk in striving for such outcomes, however, if the resultant benefits of this must be passed through, there would be limited incentive to undertake such activities.
- Notwithstanding the examples set out in the explanatory memorandum to the Bill, it is not entirely clear on what basis a determination of whether costs savings are being reflected in retail tariffs would be made, or what level of pass through would be deemed appropriate. Invariably this will be reliant on the subjective judgement of the regulator, with the implication being that any perceived failure to pass through cost savings in an 'acceptable' manner would result in a contravention of the prohibition.
- Retail tariffs are largely based on estimates of future costs, meaning there can be a mismatch between the timing of any realised cost savings and the setting of retail tariffs. This is likely to create additional uncertainty as to when a retailer would need to adjust its prices to ensure compliance.
- The regulator's task would be made more challenging by having to form a view of a retailer's costs at a point in time, which is difficult given the cyclical nature of the energy market. For example, where a retailer owns generation, in a relatively low wholesale price period, (taking into consideration the fixed cost of the investment), the retailer's generation could be a higher cost source of energy relative to the market. In such a scenario the retailer would have limited means of passing this through in retail prices. This is one of the inherent risks participants incur when investing in generation. However, if a retailer is then compelled to pass through savings at periods where generation costs are lower than market prices, this inherent risk is amplified as the asymmetric approach removes any potential upside for the investor. This runs the risk of an investor recovering less than the long run cost of its investment. While the explanatory memorandum seeks to clarify issues such as these, the wording in the actual Bill itself creates significant uncertainty as to how the legislation would be interpreted in practice.

¹ A summary of some of the key regulatory changes is provided in Section 1 of Attachment A.

Many aspects of the Bill are redundant given they duplicate existing legislation, and would only serve to create confusion and increase uncertainty

- Retail regulation. The conferral of powers on the Australian Energy Regulator (AER) to regulate retail electricity prices is unnecessary given the States and Territories have carriage of retail pricing with established review and monitoring mechanisms in place that could see the re-introduction of regulation if competition is found to be ineffective. This is consistent with the Australian Energy Market Agreement (AEMA)² which also provides for the transfer of these powers to the AER or Australian Energy Market Commission (AEMC), at the discretion of individual jurisdictions. Our understanding is that the December 2018 meeting of the COAG Energy Council re-affirmed States and Territories views on this matter.
- Financial contracting. Section 153 F seeks to ensure that gentailers do not unreasonably refuse to offer financial contracts for anti-competitive purposes. It should be noted however, that such conduct is already prohibited in certain cases under Section 46 of the *Consumer and Competition Act 2010* (CCA). Additionally, both the Energy Security Board and AEMC are overseeing work programs that examining the merits of market making³ in some regions of the National Electricity Market (NEM), that would limit any ability for gentailers to withhold contracts. The legal framework aside, vertically integrated firms are not perfectly hedged and actively participate in the contracts markets to cover customer demand, and to realise arbitrage opportunities. Therefore, the withholding of contracts to harm a competitor is not only already prohibited, but also an impractical and unsustainable strategy for a gentailer to employ.
- Wholesale spot market. Under sections 153 G and 153 H generators are prohibited from engaging in behaviour that could undermine the effective operation of the spot market. However, again such behaviour is already forbidden under the current regulatory framework. The Australian Consumer Law (ACL) and CCA respectively prohibit misleading or deceptive behaviour and firms that have substantial market power cannot engage in conduct that would substantially lessen competition. The National Electricity Rules (NER) also require generators to submit bids into the market that are not false or misleading, and each generator must submit a verifiable reason for any rebids and keep a record that is reviewable by the AER. Additionally, the AER monitors wholesale prices, with an explicit obligation to report on the underlying reasons and circumstances surrounding high price events.
- No evidence of systemic behaviour the Bill seeks to prevent. Significantly, recent forensic reviews by the ACCC, AEMC and AER found that there was no systemic pattern of behaviour indicative of the types of contraventions the Bill is seeking to prevent. The ACCC noted in its Inquiry into the Retail Electricity Market that behaviour consistent with market manipulation was not a feature of the NEM.⁴ The AER in another review found no evidence of harmful or sustained exercises of market power, and that recent whole price increases are largely attributed to plant retirement and higher fuel costs.⁵ In our view this illustrates the effectiveness of the current regulatory arrangements and negates the need for the prohibitions outlined in the Bill. Further details on the findings of these recent market reviews is provided in Section 2 of Attachment A.
- Increased uncertainty. The new prohibitions would create uncertainty for market participants as it is not clear what additional behaviours (beyond those that are already prohibited under the current

² The AEMA provides the framework for cooperation between the Commonwealth, State and Territory Governments on energy market governance and regulation.

³ Market making refers to a service within the contract market that would allow for the continuous provision of quotes to buy and sell contracts. Options for a voluntary market making mechanism are also currently being considered

⁴ ACCC 2018: Retail Electricity Pricing Inquiry – Final Report, pg. 96

⁵ AER, 'Wholesale Electricity Market Performance Report', December 2018, pg. 4; 36

regulatory framework) they are looking to restrict. This is problematic if it constrains legitimate behaviour that is consistent with the efficient operation of the market. In the context of generator bids, prohibitions that impede the ability of prices to reach a level that allows for the recovery of long run costs will reduce dynamic efficiency and undermine investment signals.

The new remedies are disproportionate to the contraventions in question, and raises concern around procedural fairness

- The introduction of powers to force divestiture of assets is a disproportionate and punitive response to the contraventions outlined in the Bill. Moreover, the industry specific nature of this power will set the electricity sector apart from other industries, increasing the difficulty in attracting capital. It could also create a precedent for extending such powers to other industries, which could in turn dissuade investment in those sectors.
- Legislation allowing the Treasurer to impose punitive measures on entities suspected of misconduct in the form of a contracting order will undermine the separation of judicial and executive powers. Under the CCA it is the courts that make a finding of a contravention, whereas under the approach set out in the Bill, the Treasurer, based on advice from the ACCC ascertains whether a firm has contravened the prohibition, and the subsequent nature of the contracting order. A court is only able to determine whether a business has failed to comply with the order, and not whether the order itself is justified. This would essentially remove a vital check and balance that is an important feature of the current regulatory arrangements.

The proposed new measures would increase the risk and impede new investment

Origin believes the ambiguous nature of the proposed prohibitions, coupled with the severity of potential penalties, will further elevate investors' perceptions of sovereign risk and regulatory uncertainty in the Australian electricity sector. This will ultimately lead to lower investment and higher costs for our customers.

If you wish to discuss any aspect of this submission further, please contact Steve Reid at

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Yours Sincerely,

Keith Robertson
General Manager, Regulatory Policy

Attachment A

1. Recent and impending regulatory reforms⁶

Regulatory change	Targeted area of improvement
Wholesale market	
Bidding in good faith – Generators are prohibited from providing false or misleading offers must record reasons for any late rebids. Commenced on 1 July 2016.	<ul style="list-style-type: none"> Increased market transparency and enhanced competition.
Increased market monitoring – Expansion of the AER's monitoring and reporting function to allow for a broader assessment of wholesale market conditions, including any market inefficiencies of competition issues. First biennial report released in December 2018.	<ul style="list-style-type: none"> Increased market transparency and enhanced competition
Notification of generator closure - Generators must provide AEMO with three-year's notice before closing. Commences 1 September 2019.	<ul style="list-style-type: none"> Increased market transparency.
Five-minute settlement – Alignment of dispatch and settlement periods at five minutes. Commences on 1 July 2021.	<ul style="list-style-type: none"> Improved price signals and bidding incentives. Enhanced competition.
Retail market	
Notification of end of fixed benefit period – Retailers are required to inform their customers when their market contract conditions end/alter. Commenced February 2018.	<ul style="list-style-type: none"> Increased market transparency.
Retail Pricing and Information Guidelines – Updated AER guidelines introduce requirements for retailers to present plan information simply and improves consistency in how retailers present energy information to customers. Commenced on 31 August 2018.	<ul style="list-style-type: none"> Increased market transparency, improved comparability between offers.
Advance notice of price changes – Requires retailers to inform customers ahead of tariff increases. Commences on 1 February 2019.	<ul style="list-style-type: none"> Increased market transparency
Strengthening protections for customers in hardship – AER to develop Hardship Guidelines that include consistent and specific statements that retailers must include in their hardship policies. The AER's Hardship Guidelines are due to be in place by 1 April 2019.	<ul style="list-style-type: none"> Improved protections for vulnerable customers.
Consumer Data Right – Allow consumers and proposed 3rd parties to more easily access data. Expected to commence in 2019.	<ul style="list-style-type: none"> Increased market transparency and improved competition.
Increased Market Monitoring – The ACCC has been tasked with monitoring and reporting on the supply of retail and wholesale electricity across all NEM regions until 2025. First report is due to be provided to the Treasurer by 31 March 2019.	<ul style="list-style-type: none"> Increased market transparency.

⁶ These reforms are supported by a range of other existing protections specified in the National Electricity Rules (NER); National Electricity Law (NEL); and Competition and Consumer Act 2010 (CCA).

Establishment of a reference price – The Australian Energy Council (AEC) and the AER have committed to developing a reference price that will be used as a point of comparison for different retail tariffs. Expected to commence by 1 July 2019.	<ul style="list-style-type: none"> Increased market transparency, improved comparability between offers.
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2. Recent market assessments do not highlight behaviour the Bill is looking to prevent

Behaviour	Finding
AER Wholesale Electricity Market Performance Report	
Rebidding	<ul style="list-style-type: none"> Spot price volatility has not been a key driver of recent price increases, with the spot price only exceeding \$300/MWh on 205 occasions in 2017-18 compared with 688 in 2016-17.⁷ While rebidding contributed to price spikes and volatility over the past five years, this behaviour was reduced by the AEMC's Bidding in Good Faith rule change and effectively stopped in mid-2017 when the Queensland Government instructed Stanwell to put downward pressure on spot prices.⁸ To this end, it should be noted the ACCC recommended that the Queensland Government should divide its generation assets into three generation portfolios to further address this.⁹
Capacity withholding	<ul style="list-style-type: none"> While deliberate withholding of capacity can create artificial shortages and spike prices that compromise competitive and efficient dispatch, the circumstances in which physical withholding is likely to be a profitable strategy are limited, because participants are paid only for electricity they generate.¹⁰ Generator availability only contributed to 16 per cent of the high price events observed by the AER over the past five years under its monitoring framework.¹¹ Further, the availability issues identified mainly related to technical reasons like unplanned outages and adjustments in response to weather conditions, rather than an attempt to exercise market power.
AEMC Gaming in rebidding assessment (Grattan Response)	
Rebidding	<ul style="list-style-type: none"> The cost of price spike events in which rebidding was the cause is estimated at \$243 million in 2017. \$214 million of this has occurred in Queensland, and virtually all in January/February 2017 before the Queensland government directed Stanwell to moderate its bidding behaviour.¹² The cost impact of rebidding has fallen since 2015 (not increased as separately reported by the Grattan Institute) and represented around one per cent of the wholesale cost of energy in the NEM in 2017.¹³ Where volatility has increased between 2015 and 2017, this has been driven by factors unrelated to rebidding, including changes in demand and generator availability.¹⁴
ACCC Retail Electricity Pricing Inquiry	
Market power	<ul style="list-style-type: none"> Clear instances of market manipulation are not a feature of the NEM.¹⁵

⁷ Ibid, pg 11.

⁸ Ibid, pg 32

⁹ Ibid.

¹⁰ Ibid, pg 48

¹¹ Ibid.

¹² AEMC, 'Gaming in rebidding assessment (Grattan Response)', 28 September 2018, pg 29.

¹³ Ibid, pg ii.

¹⁴ Ibid.

¹⁵ ACCC 2018: Retail Electricity Pricing Inquiry – Final Report, pg. 96

