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Committee Secretary
Senate Standing Committees on Economics
Department of the Senate
CANBERRA
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Submission: *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019*

CS Energy welcomes the opportunity to provide a submission on the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019* (**2019 Bill**).

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 and Wivenhoe, a pumped-storage, hydro-electric peaking plant. 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.

Comments

The 2019 Bill re-introduces into Parliament the Federal Government's *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill*, which lapsed without passing before the May election. CS Energy has previously expressed its views on the earlier Bill, making a submission to the previous Senate Standing Committees on Economics Inquiry. A copy of our previous submission is **attached.**

CS Energy re-iterates its position that it is unable to support the measures proposed to be introduced by the 2019 Bill. While CS Energy welcomes the procedural amendments that have been made to the 2019 Bill, the amendments are minor. This is disappointing given the extensive feedback from industry to address fundamental issues with the Bill, including amendments that were aimed at avoiding unintended consequences which would have delivered confidence to industry as to how to interpret and apply the law. Many of these

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amendments could have been accommodated without undermining the application of the 2019 Bill.

The Explanatory Memorandum (**EM**) does acknowledge that industry was consulted on the 2019 Bill, however it provides that the reason the Government has not adopted industry's suggested amendments is because this would "*undermine the policy objectives of the Bill*". In response to the market misconduct the 2019 Bill purports to address, CS Energy restates the following points:

- *Retail market misconduct*: The issues identified by the Australian Competition and Consumer Commission (**ACCC**) with high benchmark and complex offer structures have been addressed through the introduction of the Default Market Offer. The retail misconduct prohibition applies to market offers, for which it has never been suggested that competitively priced offers are not available.

- *Wholesale market misconduct*: The ACCC found that if there were elevated prices in the wholesale market those prices were not because of an identifiable use or abuse of market power. Further, the examples of wholesale market misconduct as provided in the EM are captured by existing market rules or by competition laws. Despite this, the 2019 Bill proposes to introduce obligations to regulate wholesale market conduct which either duplicate or are inconsistent with existing obligations. Consequently, the obligations will be difficult to interpret and apply, potentially increasing the cost of compliance, and therefore costs to consumers.

- *Contract market misconduct*: The ACCC found that market making obligations should be implemented in South Australia (and not across all NEM jurisdictions) and recommended improvements to the transparency of hedge contracting. The Australian Energy Market Commission and the ASX are progressing initiatives to address these issues. Far beyond any measure contemplated by the ACCC, the 2019 Bill will enable the Treasurer to impose on any generator a contracting order if it contravenes the contract liquidity prohibition, an unprecedent sector specific market intervention by Government with the potential to further distort that market.

CS Energy continues to be of the view that the proposed law is unnecessary and is not likely to have the effect of reducing electricity prices. Instead the law creates vague and uncertain obligations thereby heightening risk for energy market participants. At a time when Australian Governments have requested a fundamental review of the electricity market design with the aim of developing a design that sends appropriate investment signals to deliver confidence to investors, the 2019 Bill will not send a positive signal to investors and is more likely to discourage much needed investment in the energy market.

Yours sincerely

[redacted]

Teresa Scott
Market Policy Manager

[redacted]

ATTACHMENT
CS Energy Ltd Submission: *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018*

25 January 2019

Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Submission: Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018

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General comments

CS Energy is supportive of a competitive energy market that delivers fair prices for consumers. CS Energy however does not support the measures proposed to be introduced by the Bill. CS Energy is of the view that the Bill:

(a) represents unprecedented market intervention by a Government;

(b) unnecessarily duplicates existing laws in what is an already heavily regulated energy market;

(c) creates vague and uncertain obligations as to whether behaviour is or is not prohibited conduct;

(d) introduces over-reaching enforcement powers; and

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(e) ultimately, is unlikely to provide the desired price outcomes for customers.

Our detailed submission on the Bill is set out in the Attachment.

Yours sincerely

Darren Busine
Executive General Manager, Revenue Strategy

ATTACHMENT

1. DUPLICATION OF LAWS

The Explanatory Memorandum for the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill* 2018 (**EM**) states that there are no current laws regulating the kind of conduct the proposed law will prohibit in relation to retail pricing, the financial contract market or the wholesale electricity market. This is incorrect. The conduct sought to be prohibited is already captured by existing laws, relevantly:

(a) the *Competition and Consumer Act 2010* (Cth) (**CCA**) - misuse of market power;

(b) the National Electricity Law (**NEL**) and National Electricity Rules (**NER**) - regulation of dispatch offers, bids and rebids;

(c) the *Corporations Act 2001* (Cth) – market manipulation.

It is unclear why this duplication is considered necessary. In recent years, there have been no serious breaches by electricity generating entities of the existing laws referred to above and the existing laws have provided ample coverage of any misconduct by electricity companies.

CS Energy is concerned that the purpose of this Bill is to take the current regulatory regime and expand it to a point where a breach can be 'inferred' in order to give the Treasurer broad sweeping powers to remedy a 'perceived problem'.

However, in CS Energy's view, the proposed law will not address the issues identified by the Australian Competition and Consumer Commission (**ACCC**) in its Retail Electricity Pricing Inquiry – Final Report June 2018 (**Final Report**), being consumer confusion about electricity price offers and the difficulty in identifying and switching to better deals.

2. RETAIL PRICING

(a) Underlying cost of procuring electricity

The retail pricing prohibition is triggered if a retailer fails to make a reasonable adjustment where there is a sustained and substantial decrease in its '*underlying cost of procuring electricity*'. This term is not defined in the Bill. The EM provides that these costs include wholesale costs, network costs and environmental costs, however, retail costs and retail margins are not included as a '*cost of procuring electricity*'. It is not clear why these costs have been excluded, given these amount to 16 percent of the average residential customer's bill[1].

The EM suggests that a reduction in supply chain costs must be passed through, however, a reduction in retail costs does not need to be passed through. This seems a perverse outcome. It is not clear why all cost decreases or increases are not taken into consideration, and contrary to the policy intention of the legislation.

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[1] ACCC's Final Report, Figure 1.1.

(b) **Reasonable adjustments**

The Bill requires retailers to make '*reasonable adjustments*' to the price of its offers. This requirement is vague and will be difficult to comply with. The Bill does not provide any guidance as to how a retailer determines what a 'reasonable adjustment' is, or when (or how often) an adjustment should be made. Further, the EM does not provide any assistance as the examples in the EM do not accurately reflect how the electricity market operates. Relevantly:

i. Retail prices are largely determined by reference to their underlying hedge portfolio, which is built up over a long lead time, as depicted in the QCAs benchmark retail price methodology[2] (and generally commencing about two years in advance of the relevant period[3]). A reduction in current wholesale spot prices will not reduce the offer price for the current period as these prices will be determined by reference to the contract price of the hedge portfolio (for which the price is set at the time the hedge was entered into). While a hedge can be unwound, this can only be done at a cost.

ii. To the extent the retail portfolio is hedged, the underlying cost of electricity will be the contract price under the hedge. A reduction in the wholesale spot price will not provide an offset in the reduction of the 'wholesale costs' as stated in the EM.

CS Energy is concerned that this uncertainty does not bode well for compliance with, or enforcement of, the proposed law.

(c) **Application limited to small customers**

A concerning feature of the legislation is that it only applies to retailing to small customers (residential customers and business customers with consumption of less than 100MWh annually). However, the prohibition may have the unintended consequence of distorting pricing between large and small customers in the retail market, with large customers subsidising small customers (as retailers make larger than necessary pricing adjustments for small customers to ensure they do not contravene the prohibition). CS Energy believes any divergence in a retailer's ability to recover underlying costs from the appropriate customers is likely to be detrimental to large energy users.

3. ELECTRICITY FINANICAL CONTRACT LIQUIDITY

(a) **Behaviour in relation to offering contracts**

The EM makes it clear that a corporation such as CS Energy would breach the electricity financial contracts liquidity prohibited conduct provision if it offers to enter into contracts in a way that limits the ability of other corporations to accept the offers. For example, this would be the case, if the contract is offered on such commercially unattractive terms that no reasonable counterparty would be likely to accept. While this requirement seems harmless, CS Energy is concerned that it may be used by certain counterparties that are unable to reach contractual

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2 Queensland Competition Authority, *Final determination Regulated retail electricity prices for 2018–19*, p 37.

3 ACCC's Final Report, p 109.

agreements on full commercial terms to assert a breach of the prohibited conduct provisions.

CS Energy is also concerned that neither the Bill (or the EM) makes any reference to prudential requirements. Financial contracts in the electricity industry are traded on the ASX or through over the counter (**OTC**) contracts. Retailers seeking to access the ASX will need to find an ASX clearing house and satisfy the clearing participant of its credit worthiness. For OTC trades, most trades in the electricity industry are in the form of the ISDA Master Agreement (incorporating the AFMA recommended amendments) and the commercial terms that are typically 'unattractive' are the credit requirements, which small retailers are not always able to meet.

(b) Contracting orders

In making a contracting order, the Treasurer must specify:

- the type of derivative that must be offered, including the price and the minimum number of MW;
- the manner in which the offers must be made;
- the kinds of entities to which those offers must be made; and
- the periods during which the offer must be made (which must start six months after the order is given, and contracts can be three years in duration).

While the EM refers to several matters the Treasurer may consider as relevant, it is silent on the following matters that are key to a generator's contracting position:

- the underlying cost stack of the generator;
- the risk policy of the generator; and
- the prudential requirements of the generator.

CS Energy is of the view that this is significant over-reach by the Government into a corporation's commercial operations, in circumstances where there is a misunderstanding of how contracting decisions are made.

4. ELECTRICITY SPOT MARKET

(a) Overlap with the NER

The law will prohibit generators from acting '*fraudulently, dishonestly or in bad faith*' when making bids or offers on the spot market. In discussing this concept, the EM states '*for example, in placing a bid, a generator is representing to the market that it intends to dispatch a certain quantity of electricity at a certain price. If, at the time of placing the bid, the generator does not intend to honour its bid, placing that bid is likely to be considered dishonest and an act of bad faith*'[4].

This is a clear overlap of section 3.8.20 of the NER, which prohibits a generator making a false or misleading offer, bid or rebid. By attempting to regulate the same conduct but in a different form, it implies a different standard, and will be extraordinarily confusing for market participants and regulators.

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[4] EM, p 28.

Additionally, reimposing a bad faith requirement creates considerable uncertainty for market participants. Section 3.8.20 was previously framed in the context of a 'good faith' obligation, however was replaced with the current prohibition as the 'good faith' obligation was considered too subjective and difficult to establish (following the Stanwell decision[5]). The Rule change was made only after a lengthy 18-month consultation process (partly due to the Australian Energy Market Commission extending the time to consider the Rule change request due to the complexity of the issues raised). This highlights the already complex nature of the issues the subject of the proposed electricity spot market prohibited conduct provision.

(b) **Distortion or manipulation of market prices**

The EM indicates that a distinction must be made between behaviour that takes advantage of higher prices and behaviour that causes high prices[6]. While the EM acknowledges that the distinction will be hard to prove, CS Energy is very concerned that a generator that sets the price (referred to as the 'marginal generator') at an undefined (but politically unacceptable) high level could be in breach of the electricity spot market prohibited conduct provision.

The market price cap is in play for a reason, and the price at which the marginal generator is dispatched is reflective of supply and demand on that day and how that generator has bid its capacity into the market on that day. A generator's bid reflects several underlying factors, including how the generator values its fuel on a given day and, during periods of high spot prices, the opportunity to recover fixed costs and a return on capital investment.

The EM is silent on how the current prohibition under the NER (which prohibits a generator making a false or misleading offer, bid or rebid) does not adequately regulate this conduct. As noted above, there has been no serious breach of the existing laws, including section 3.8.20 of the NER, by electricity generating entities.

(c) **Operation of the market**

In line with our comments in section 2(b) above, the examples given in the EM misrepresent how the electricity market operates. Relevantly:

i. Several examples refer to generators not bidding capacity into the spot market for a given day[7]. Under the NER, all scheduled and semi-scheduled generators must participate in the central dispatch process and must provide bids in accordance with the AEMO timetable, which requires bids for each trading day to be submitted by 12.30 pm the previous day. In submitting bids, available capacity is determined by reference to the name plate capacity of the plant, reduced for operational requirements such as fuel constraints, planned outages and technical limitations[8].

ii. While scheduled and semi-scheduled generators who operate peaking plants must bid capacity for each trading day, capacity will be bid at a price such that the generator is unlikely to be dispatched in order to meet demand.

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5 *Australian Energy Regulator v Stanwell Corporation Limited* 197 FCR 429.
6 EM, example 2.15.
7 EM, examples 2.15 and 2.19.
8 For example, extreme hot weather events reduce the output of coal-fired power stations.

iii. The scenario provided in example 2.19 in the EM contemplates that a generator will not bid on a given day as the bid given by 'Generator E' one day prior is a low price. As noted above, all scheduled and semi-scheduled generators must provide bids in accordance with the AEMO timetable. Importantly, generators do not see pre-dispatch bids (including price offers) made by other generators. This information is not available to the market until after the trading day closes.

5. PURPOSE TEST

The Bill introduces a 'purpose' requirement for the electricity financial contract liquidity and the electricity spot market prohibited conduct. The EM expressly provides that where behaviour has the effect or likely effect of substantially lessening competition but does not have the purpose of substantially lessening competition, the prohibition will not be contravened.

This seems a perverse outcome as the legislation will confer extreme enforcement powers in respect of conduct that may not have any anti-competitive effect (and, therefore, will not be detrimental to consumers).

Given this, to impose a 'purpose' requirement does not appear to be justified.

6. INFORMATION GATHERING POWERS

The Bill significantly bolsters the ACCC's information gathering powers. The proposed law will permit the AER to give the ACCC all information it has gathered for purposes associated with the proposed law. This includes information obtained through the section 28 notice and information gathering provisions under the NEL, which may not have been obtained for the purpose of investigating a breach of the proposed law. The Bill also contains amendments that will permit the AER to 'interview' individuals under its information gathering powers (similar to amendments to the NEL currently under consideration). CS Energy is concerned with the extent of these powers given the low evidentiary burdens to establish a breach, relevantly:

- the ACCC can infer 'purpose' to establish a breach of the prohibited conduct provisions; and
- the ACCC does not have to establish a breach, it is only required to form a '*reasonable belief*', refer our comments in section 7(b) below.

In respect of the proposed 'interview' right, this right has been strongly rejected by industry in respect of the proposed amendments to the NEL. This is a serious concern to CS Energy, as it does not consider it appropriate that our trading staff may be compelled to attend formal 'evidence gathering' interviews in respect of conduct that calls for fine technical, financial and operational judgements to be made. Typically, the power to compel a person to answer questions in an examination is the kind of power that has been historically reserved for courts.

7. CONTRACTING AND DIVESTITURE ORDERS

(a) Generators discriminated against

The proposed enforcement powers clearly discriminate against generators. Although retailers must amend their offers if their supply chain costs decrease, if they do not, retailers are not subject to a divesture order. A divestiture order is saved purely for generators that have engaged in prohibited conduct in respect of spot market bidding. Retailers are also not subject to unwarranted intervention in its business affairs through the making of a contracting order.

While CS Energy does not support the enhanced enforcement powers, there does not appear to be any basis for this discrimination. The proposed law will further erode the incentives for corporations such as CS Energy to invest in new generation.

(b) No requirement to establish the prohibited conduct

The Regulation Impact Statement attached to the EM states that the Bill has been designed to put sufficiently clear criteria around when and how the remedies can be used. CS Energy strongly disagrees with this statement.

The ACCC will be able to a give a prohibited conduct notice if it '*reasonably believes*' that the prohibited conduct has been engaged in. Similarly, the Treasurer may make a contracting order if it is '*satisfied*' of certain matters.

There is no requirement that the ACCC or the Treasurer establish that prohibited conduct has in fact occurred. Rather, the notice or order can be given based simply on their belief. Typically, such extreme enforcement powers would be reserved for a court and would only be exercised in circumstances where there has been clear, proven misconduct.

8. APPLICATION TO THE STATE OF QUEENSLAND

The Bill expressly:

- binds the Crown in right of the State; and
- provides that State-owned assets may be sold to other State entities provided that the other State entity is genuinely in competition in relation to electricity markets with the entity that is the subject of the divestiture order.

Although the Bill specifically references section 51(xxxi) of the Constitution, it remains unclear as to whether the proposed divestiture powers can be exercised against a State-owned corporation.

CS Energy is of the view that these powers are an unwarranted constitutional over-reach into State-owned assets and will erode the incentives for CS Energy to further invest in new generation.

9. OTHER COMMENTS

The Bill does not create prohibitions on conduct by electricity network businesses. This approach plainly ignores a significant supply chain cost into a consumer's electricity bill, which is on average 43 percent of the average residential customer's bill[9]. The ACCC made 56 recommendations in its Final Report setting out the action that should be taken across the electricity industry to reduce retail electricity prices, including recommendations to lower network costs. However, the Bill makes no attempt to address this significant component of the cost stack or otherwise implement any of the ACCC's recommendations as proposed by the ACCC.

[9] ACCC's Final Report, Figure 1.1.