



COAG
Energy Council

ENERGY SECURITY BOARD CONSULTATION PAPER

ACCC Retail Electricity Pricing Inquiry
Recommendation 41
February 2019

1. Purpose

Recommendation 41 of the ACCC's *Retail Electricity Pricing Inquiry*

The AER's wholesale market monitoring functions should be expanded and appropriately funded to include monitoring, analysing and reporting on the contract market. This should include analysing the data reported to the OTC repository (Recommendation 6), ASX data and data gathered directly from retailers and generators (including through the use of compulsory information gathering powers).

The Energy Security Board (ESB) is seeking stakeholder views on the following questions:

- Are there existing constraints on the AER's information gathering powers that could be removed to allow it to effectively monitor the contract markets in both gas and electricity? Should restrictions imposed under section 18D of the National Electricity Law (NEL) on information gathered under section 28 the NEL, relating to wholesale market monitoring, be removed or amended? Similarly, should the National Electricity Law be amended to allow a regulatory information notice or order to be issued to market participants other than network businesses.
 - Given, the Australian Securities and Investment Commission (ASIC) currently monitors and regulates the contract markets associated with the NEM, as well as other commodity markets, what considerations should be taken in to account in how the AER performs its role in monitoring, analysing and reporting on the contract markets for gas and electricity to ensure effective and efficient regulation, and avoid overlap in the roles and responsibilities of the two regulators?
- Is an OTC trade repository required for the AER to access the information it requires to effectively undertake its wholesale market monitoring function? If a repository is established, should it be a specific purpose repository for reporting energy OTC contracts, or could an existing trade repository be used? Should the AER also be able to access data on exchange traded contracts (ASX and other) to a similar level of detail to that which would be reported in a trade repository? Are there other measures which could be implemented instead of an OTC trade repository (e.g. enhanced industry survey such as the AFMA survey) that would enable the AER to effectively undertake its wholesale market monitoring function?

2. Consultation timetable

The ESB invites comments from interested parties by **8 March 2019**. Feedback received will inform the ESB's advice to the COAG Energy Council.

Submission close date	8 March 2019
Lodgement details	Email to: info@esb.org.au
Naming of submission document	[Company name] Response to ACCC Recommendation 41 Consultation Paper
Late submissions	Late submissions will not be accepted
Publications	Submissions will be published on the COAG Energy Council's website, following a review for claims of confidentiality.

3. Introduction

ACCC Retail Electricity Pricing Inquiry Final Report

In Chapter 16 (*Measuring outcomes and improvements in the market and appropriate tools for the AER*) of its report, the ACCC noted the AER's current market monitoring powers did not specifically extend to monitoring of contract markets and recommended (**Recommendation 41**) that the AER's wholesale monitoring functions should be explicitly expanded to include monitoring, analysing and reporting on contract markets. The ACCC considered that this explicit expansion of the AER's functions should include analysing the OTC contract information reported to a trade repository (see below).

In Chapter 5 (*Contract markets and their impacts*) of its report, the ACCC stated that it considered that the lack of transparency in the OTC market impeded the transmission of price signals in the market and introduced uncertainty for participants and policy makers. It recommended (**Recommendation 6**) that this uncertainty could be overcome by a requirement for OTC trades to be reported to a registry (a trade repository) and then published in a de-identified format. The ACCC's priority is in enhancing transparency of OTC market activity and price trends.

After undertaking stakeholder consultation on **Recommendation 6** (September 2018) and considering the responses, the ESB is not convinced that a trade repository and mandatory reporting of OTC trades is justified on transparency grounds alone given the expense of establishing and maintaining the repository, as well as the reporting burden on participants. However, the ESB is working with the AER to determine what constraints on its information gathering powers may undermine the AER's ability to effectively monitor, analyse and report on the contract market and whether a trade repository is required for the AER to undertake market monitoring and compliance on the wholesale market (including the contract market) (**Recommendation 41**); this paper seeks the views of stakeholders on these issues.

4. Background

Current AER functions

The AER is required to undertake a range of wholesale market monitoring and enforcement functions in both electricity and gas markets.

The AER monitors electricity and gas market participants' compliance with the National Electricity Laws and Rules and the National Gas Law and Rules. It takes formal enforcement action against breaches. It reports on its compliance monitoring and enforcement activities, including reports on specific compliance issues and major market incidents.

The AER also monitors the performance of the National Electricity Market (NEM) and the wholesale gas commodity and pipeline capacity markets located in eastern and north Australia. The AER's wholesale market reporting in electricity and gas includes weekly analysis and detailed reports into high-price events. The AER also publishes the State of the Energy Market report annually and long-term statistics on its website, which includes summary information on market outcomes.

In addition, the AER is required to monitor and review the performance of the NEM, including whether it is effectively competitive and report every two years. In assessing effective competition, the AER has regard to a number of factors including:¹

- whether there are active competitors
- whether prices are determined on a long-term basis by underlying cost
- whether there are barriers to entry into the market
- whether there is independent rivalry in the market.

The AER also assists with the AEMC's biannual review of the liquidity of gas markets through developing and publishing data to enable an assessment of the performance of gas markets over time.

5. Issues

Linkages between gas and electricity markets

There are strong links between the electricity and gas spot markets. Gas is a key fuel for generation in the NEM. During peak demand periods gas powered generation is often the marginal generator setting prices across the market. Given this, gas prices can have a significant impact on the electricity market. High gas prices can flow through to higher electricity prices. But the reverse can be true too. Strong demand for gas for electricity generation has an effect on gas markets, including higher gas prices at times.

The significant number of participants that operate in both markets also highlights the potential links between the markets. Some electricity market participants have interests in upstream gas production or storage facilities, while others regularly participate in gas markets to secure gas for electricity generation. Market participant behaviour in the wholesale gas market can affect outcomes and prices in the wholesale electricity market and vice-versa. Participants that operate in both markets will price arbitrage between the two

¹ The full definition of effective competition is set out in section 18B of the National Electricity Law.

markets when deciding whether to supply gas to generate electricity or sell back to the market.

The interrelationships between the markets has the potential to grow further with the projected increased integration of variable electricity generation. Increased penetration of variable generation may mean that the system will require additional flexible capacity (such as gas or hydro) that can respond to changes in output to manage potential reliability and security challenges. This could bring about greater demand for gas powered generation in future.

There are also strong links between the physical spot gas and electricity markets and the contract markets. Most wholesale electricity and gas market participants will participate in both spot and contract markets to manage their gas and electricity portfolios:

- Electricity market participants will trade electricity derivatives products in two ways: on the Australian Stock Exchange (ASX) or directly with a counterparty (often with the assistance of a broker) known as over-the-counter transactions.
- Gas market participants will often enter into 'off market' contracts to buy and sell gas in addition to participating in the facilitated spot markets in Victoria, Sydney, Adelaide, Brisbane, Moomba and Wallumbilla. There are also a number of gas derivatives products available on the ASX which are starting to trade.

Contract markets are critical to the operation and effectiveness of the gas and electricity markets. Contract markets allow participants to manage risk. For example, electricity market participants will enter into a range of contracts to manage their exposure to spot price volatility in the NEM. Contracts can also support new investment as they provide greater levels of revenue certainty over the long term. For this reason, a lack of availability of contract products can also act as a barrier to entry for new electricity generators in the electricity markets.

The degree to which participants have entered into contract arrangements is likely to affect behaviour in gas and electricity spot markets. This is because entering into long term contracts can affect a participant's incentives to offer capacity in the short-term spot markets. The links between the markets can also provide opportunities for cross market manipulation. For example, off market contracts in gas markets may be settled by reference to prices on the Wallumbilla hub. In some circumstances, a participant may have an incentive to manipulate prices on the hub in order to gain benefit under an off-market contract.

Currently the AER has access to public information on ASX traded products (primarily prices and volumes traded) but does not have access to non-public information on the parties to these transactions. Routine access to OTC transactions is even more limited, with the AER primarily relying on voluntary participant surveys conducted by the Australian Financial Markets Association. The AER does not obtain any routine information on off market gas trades. This situation is in stark contrast to the NEM and the facilitated gas markets in Victoria, Sydney, Adelaide, Brisbane and Wallumbilla, where the AER has routine access to all public and confidential market data.

Other similar international energy regulators have routine access to non-public contract information. For example, in 2014 the United States Federal Energy Regulatory Commission (FERC) gained access to participant specific information on exchange based financial positions – known as a large traders report - from the US Commodity Futures Trade Commission. The US FERC routinely uses this report in its surveillance program. The electricity regulator in New Zealand, the Electricity Authority, has access to electricity contract information via the New Zealand electricity hedge disclosure system. Electricity

market participants are required to report hedge contract information within five business days of entering into each contract. The Electricity Authority uses the contract details provided under the regime to monitor the performance of the electricity supply chain, including the contract markets as well as detect potential market manipulation. The contract information is published on a freely available website with arrangements that ensure disclosures are anonymous and eliminate commercial sensitivity around individual hedges.

The lack of routine access to gas and electricity contract market data presents significant challenges to the AER's market performance and compliance monitoring. For example, the lack of access to off-market bilateral contracts for the purchase and sale of gas at Wallumbilla presents challenges in monitoring compliance with the market manipulation provisions in the National Gas Rules. Access to contract market information would also assist the AER in monitoring the performance and competitiveness of the markets over the long term. This information would assist the AER to better understand the drivers of participant behaviour and investment decisions.

Current AER information powers are fragmented and function specific

The AER has a number of existing information gathering powers under the National Electricity Law and National Gas Law. These information gathering powers are linked to the AER's performance or exercise of functions or powers conferred on it under the National Electricity Law or National Electricity Rules or the National Gas Law.

The AER has general information gathering powers under Part 3, Division 3 of the National Electricity Law. Under section 28, the AER has the power to issue a notice to a person where it has reason to believe that a person is capable of providing information or producing a document that the AER requires for the performance or exercise of its functions or powers under the National Electricity Law or National Electricity Rules. There is an equivalent information gathering power in section 42 of the National Gas Law.

There are particular requirements in the National Electricity Law for the provision, use and disclosure of information in relation to the AER's wholesale market monitoring functions. Under section 18D(1)(a) of the NEL the AER must use publicly available information in the first instance to identify whether:

- there is effective competition within the market
- there are features of the market that may be detrimental to effective competition or that maybe impacting detrimentally on the efficient functioning of the market.

If the AER identifies a relevant matter it may obtain additional information under its information gathering powers. This means the AER may not use its compulsory information gathering powers for preliminary information gathering for market monitoring.

There are also a number of restrictions in section 18D (2)–(6) of the National Electricity Law on the use and disclosure of information obtained under section 28 for the purposes of the AER's wholesale market monitoring functions:

- Any information obtained under section 28 for the purpose of the market monitoring function is taken to have been given in confidence.
- The AER must not use this information for any purpose other than the performance of the wholesale market monitoring or reporting functions. For example the information obtained could not be used for an enforcement or compliance monitoring function.

- The AER must not disclose the confidential information unless the disclosure is for the wholesale market monitoring or reporting functions and the information is combined or arranged in a way that does not reveal any confidential aspects of the information or identify the wholesale electricity supplier to whom it relates. This means that the AER cannot share information it receives, including with the other energy market institutions (for example the ACCC or ASIC) even where the information directly relates to the functions of these agencies.
- The AER must return any documents obtained within 12 months or as soon as reasonably practical after 12 months.

For some of its other functions the AER has been able to require the periodic reporting of information in a specified format. In addition to the AER's general information gathering powers under Division 3, the AER has the power to issue regulatory information notices and regulatory information orders to network service providers under Part 3, Division 4 of the National Electricity Law. These orders and notices can require regulated network service providers to provide the AER with specified information or prepare, maintain or keep specified information in a manner and form specified by the AER. The AER can issue notices and orders where it considers it reasonably necessary for the performance or exercise of its functions or powers under the National Electricity Law and National Electricity Rules. There are equivalent powers in Part 1, Division 4 of the National Gas Law.

Similar to section 28 notices, a regulatory information notice or order can require regulated network service providers to provide information specified in the notice or order. Unlike section 28 notices however, the notice can also require that a network service provider prepare, maintain or keep information specified in the notice or order in the manner and form specified in the notice. The AER has used these provisions to require periodic, systematic reporting of network data for network determinations, benchmarking and periodic performance reporting. Reporting of information in this manner has supported new approaches to network regulation and a deeper understanding of the network sector.

The AER can only use these notices and orders to obtain information from regulated network service providers. They cannot be used to obtain information from generators for example. There is no equivalent provision in the National Electricity Law which provides the AER with the power to issue regulatory information notices or orders to other NEM participants (such as generators or retailers) to achieve the systematic reporting of contract data.

A number of factors exist that may prevent the AER using its existing information gathering powers for gathering contract information. For example, the AER can only serve a section 28 notice requiring the production of information and documents where they are required for the performance or exercise of its functions and powers under the National Electricity Law or National Electricity Rules or the National Gas Law or National Gas Rules. Currently there is no explicit function or power for the AER to monitor contract markets in the gas or electricity markets. The AER's wholesale electricity market monitoring and reporting functions apply to wholesale electricity markets which is defined as any wholesale market regulated under the Law or Rules (which do not currently include contract markets).

The National Electricity Rules do include provisions for reporting requirements and monitoring standards for Registered Participants and AEMO. Under clause 8.7.2 of the National Electricity Rules the AER must establish reporting requirements that apply to particular categories of Registered Participants and AEMO in relation to matters relevant to the Rules. However, the National Electricity Rules does not currently provide for AER monitoring and reporting on the contract markets.

The proposed Retailer Reliability Obligation (RRO) also requires the AER to take on compliance roles to ensure that liable entities have sufficient qualifying contracts when required to meet their obligation and in relation to the Market Liquidity Obligation. The establishment of these roles under the RRO creates a risk of further fragmentation of information gathering powers and suggests the need to establish a more holistic market monitoring function that can support the AER in discharging its roles across a range of areas including the RRO and broader monitoring of the wholesale electricity market.

6. Options for expanding AER's wholesale market monitoring function

- A. Improve the AER's market information gathering powers both with and without a trade repository and/or
- B. Establish a trade repository

A. Potential Improvements to AER's Information Gathering Powers

ESB preliminary views (NB: from the paper that went to COAG EC)

The ESB agrees with the ACCC's conclusion that understanding activity in the contract market is essential to assessing competition in the wholesale market. The AER has also acknowledged the importance of the contract market for the purposes of undertaking its wholesale monitoring function.

However, the ESB is concerned that the AER's information gathering powers in relation to its wholesale market monitoring function may not be fit for purpose to examine all relevant facets of the contract market. The ESB is interested in stakeholder views on whether current impediments to the AER's information gathering powers (including with respect to s 18D and s28 of the NEL – see Section 3 – Issues) is reducing the effectiveness of the AER in undertaking its market monitoring function. In particular, the ESB is interested in stakeholder views on whether removing impediments from the AER's information gathering powers would be preferable to establishing a trade repository or whether improvements to information gathering powers complemented by the establishment of a trade repository for reporting of OTC trades would be preferred.

Questions for stakeholders

Are there existing constraints on the AER's information gathering powers that could be removed to allow it to effectively monitor the contract markets in both gas and electricity?

Should restrictions imposed under section 18D of the National Electricity Law (NEL) on information gathered under section 28 the NEL, relating to wholesale market monitoring, be removed or amended? Similarly, should the National Electricity Law be amended to allow a regulatory information notice or order to be issued to market participants other than network businesses?

How can the AER's role be designed to be effective while avoiding overlap with the role of the Australian Securities and Investment Commission in contract markets for gas and electricity?

B. Trade Repository

A trade repository if established would provide the AER with information on price, volume, duration and location as well as the identities of the parties to the trades.

Potential models for a trade repository

1. Specific purpose trade repository administered by the AER versus leveraging an existing, generic trade repository.

Issues around establishing an industry specific trade repository versus leveraging an existing generic trade repository were considered in the ESB's consultation paper on Recommendation 6 (September 2018). In that paper, the Board noted that establishing a new industry specific trade repository would involve considerable development lead-times and significant up-front costs.

In response to the ESB's consultation paper on ACCC's **Recommendation 6** (September 2018, stakeholders raised concerns that reporting of bespoke OTC products would be challenging, with the information provided likely to be of limited usefulness or, at worst, misleading. Large energy users were also adamant that price information be excluded from any reporting as such information is highly commercially sensitive.

Alternative reporting model – e.g. New Zealand model for web-based reporting of OTC trades

New Zealand provides a web -based system for participants to upload OTC contract trades. The main purpose appears to be to allow participants to use the information disclosed on contracts to create historic cost curves or forward price curves. Only participants are required to submit contract details. Non-participants are exempt because the Electricity Authority considers that their inclusion would result in increased compliance costs with little additional assurance around disclosure. If the seller is a participant, it's required to submit, but if the seller is not a participant and the buyer is a participant, the buyer must submit. The contract price reported is a standardised version of the original price negotiated in the risk management contract. The standardised version is the time weighted, location and loss-adjusted version of the contract price.

OTC market for electricity contracts vs ASX

The OTC market remains a substantially smaller portion of the contract market than trades undertaken on the ASX. Data from the AFMA industry survey suggests that the OTC market is around 20 per cent of the total electricity contract market. Contracts traded through the ASX represent the vast majority of contracts traded. ASX contracts are traded anonymously and the AER does not have visibility on the identity of parties for the vast majority of the electricity contract market. Information provided to a trade repository would provide the AER with access to the identities of the contracting parties.

Questions for stakeholders

Is an OTC trade repository required for the AER to access the information it requires to effectively undertake its wholesale market monitoring function?

If a repository is established, should it be a specific purpose repository for reporting energy OTC contracts, or could an existing trade repository be used?

Should the AER also be able to access data on exchange traded contracts (ASX and other) to a similar level of detail to that which would be reported in a trade repository?

Are there other measures which could be implemented instead of an OTC trade repository (e.g. enhanced industry survey such as the AFMA survey) that would enable the AER to effectively undertake its wholesale market monitoring function?