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Energy Ministers Secretariat
Department of Climate Change, Energy, the Environment and Water
GPO Box 858
Canberra, ACT, 2601

Dear Energy Ministers Secretariat

Re: Amending the Australian Energy Regulator Wholesale Market Monitoring and Reporting Framework Consultation Paper

The Australian Energy Regulator (AER) strongly supports amending the wholesale energy market monitoring and reporting framework as outlined in the consultation paper. We consider the following amendments should be made to the existing framework:

- removing the public information limitations in the National Electricity Law (NEL section 18D) which are impeding upon the AER's electricity wholesale monitoring function,
- expanding the scope of the electricity market monitoring functions to include contract markets, and
- adapting the National Gas Law (NGL) to include an equivalent market monitoring function for gas.

Amending the framework would represent an important step in the AER's ability to assess competition in the wholesale energy markets and ensure consumers are not unduly impacted by high energy prices due to an uncompetitive market. This reform is especially important as the energy market transitions and the composition of energy generation continues to evolve.

Recent market events have highlighted the importance of the reforms outlined in the consultation paper. In recent months the east coast gas markets¹ and the National Electricity Market (NEM) have experienced unprecedented turmoil. A mix of factors including unanticipated generation outages, persistent high international commodity prices and

¹ In particular the Adelaide, Brisbane, Sydney STTM and Victorian downstream gas markets which except for the Adelaide STTM all had administered pricing arrangement and all have had sustained pricing above \$30/GJ over June

unseasonal domestic weather conditions have had a marked impact on market outcomes. Throughout this period the behaviour and incentives of market participants have been questioned by governments and communities alike. As the regulator, the AER is expected to provide analysis determining whether high prices are being driven by underlying market dynamics or are being exacerbated by participant behaviour.

However, we are currently limited in our ability to undertake the analysis required to perform this critical role due to restrictions obtaining and using information, our limited visibility over electricity and gas contracts, and the lack of a comprehensive market monitoring reporting role in gas.² Every megawatt hour of electricity is traded multiple times in the secondary markets. The cumulative value of this trade is worth many multiples of the settled spot market price. Participants also use a range of additional contract products to manage wholesale market risk such as fuel contracts, power purchase agreements and weather derivatives. All these transactions determine the overall incentives driving each market participants behaviour. By being confined to examining the spot market, we are only seeing the tip of the iceberg.

The rest of this submission comments on the major amendments required to the wholesale market monitoring and reporting framework in these three areas as identified in the consultation paper.

Removing the constraints created by section 18D of the NEL

As highlighted in the consultation paper, the AER's monitoring and reporting powers are constrained by section 18D of the NEL. The restrictions in section 18D require the AER to have first identified a "relevant matter" through publicly available information, before it can use compulsory information gathering powers to request information directly from market participants.

Section 18D also requires the AER not to use confidential supplier information for any purpose other than the performance of the AER's wholesale market monitoring functions and not disclose confidential supplier information unless it is for the purposes of these market monitoring functions (and it has been arranged to not reveal confidential aspects or identify the wholesale supplier).

These constraints were intended to address concerns about commercial sensitivity of information collected under the wholesale market monitoring functions, however in practice they have significantly limited our capacity to monitor the market and take action in relation to identified issues.

Recent events have emphasised problems with these limitations. The fact that an issue must be identified with publicly available information before we can use compulsory information gathering powers to request information from participants has a significant impact on the AER's ability to proactively monitor developing issues in the NEM. There is very little public information available on contract markets and participant risk management strategies and tools, this makes it very challenging to identify matters requiring further investigation. This in

² Contracts as defined in Appendix A Indicative drafting of key elements of the WMM reform package, in the Amending the Australian Energy Regulator wholesale market monitoring and reporting framework consultation paper.

turn leads to delays in collecting and analysing the information necessary to effectively assess wholesale market competition and provide policy makers with timely advice and potential solutions to market issues. Furthermore, the lack of ability to proactively monitor contract markets hampered our ability to understand the coming crisis and then respond.

It is therefore imperative that the current restrictions to the AER's wholesale market monitoring information gathering powers are removed. By repealing s 18D of the NEL, the AER would be able to obtain information and documents required to effectively monitor the market without first relying on publicly available information to identify a problem. Further, information and documents obtained by the AER in the exercise of wholesale monitoring functions would not automatically be deemed confidential and could be used for other purposes.

As highlighted in the consultation paper, this does not mean that the AER would have an unfettered ability to disclose information given in confidence. The NEL contains extensive provisions which regulate disclosure of confidential information which would continue to apply.³ We agree with the view expressed in the consultation paper that this provides appropriate safeguards on disclosure of information provided in confidence.

Expanding the scope of the AER's electricity market monitoring functions to include contract markets

As highlighted in the consultation paper, the AER's ability to undertake wholesale market monitoring is significantly compromised by our lack of visibility of contract markets.

The contract market allows wholesale and retail participants to manage risks associated with price volatility in the wholesale market. As such, contract markets are intertwined with the physical spot markets for both gas and electricity.

As identified in the consultation paper, lack of visibility over contract markets means that the AER is limited in its capacity to:

- identify a significant volume of energy traded through contracts either on an exchange or through over-the-counter (OTC) trades
- quantify market liquidity through analysis of the volume of energy traded across various contracts and trends in trading activity
- gain visibility of the forms of contracts being traded and how that will relate to wholesale electricity trading and efficient competition
- assess relative price discovery of electricity traded and the spread between bids and offers; and
- identify market inefficiencies and the causes of any inefficiencies.

³ See NEL Part 3, Division 6 (e.g. ss28W – 28ZB).

The issues associated with this lack of visibility over contract markets have been known for some time. Both the ACCC and the AER have previously found that we are limited in our ability to interpret the electricity market without access to contract market information. The ACCC, in the 2018 retail electricity pricing inquiry, recognised the importance of contract market information to wholesale market analysis and recommended:

The AER's wholesale market monitoring 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 over-the-counter (OTC) repository (recommendation 6), ASX data and data gathered directly from generators and retailers (including through the use of compulsory information gathering powers).⁴

The ACCC found that the big three electricity gentailers can achieve lower over-the-counter prices than other, smaller, market participants. The ACCC also received submissions that suggested the contract markets do not work sufficiently to allow small and standalone retailers to manage their risk.

The AER, in our wholesale electricity market performance reports (WEMPR), also noted that the contract market underpins risk management.⁵ The contract market must be liquid to enable participants to buy and sell contracts to manage their financial risk. The AER found that traded volumes of standard contracts in 2019-20 almost doubled compared to the 2017-18 reporting period, indicating improved liquidity in the contract market. However, without access to participant contract information, we were unable to conclude what the underlying causes of these significant changes in contract liquidity were (i.e. whether the contract market was contributing to competition in either the wholesale or retail electricity markets). Having access to the relevant underlying contracts information could have allowed the AER to make conclusions about the causes of market events and assess whether the changes were transient or the result of sustained changes in market dynamics.

The issues associated with this lack of access to energy contract information have again been highlighted during the current energy crisis. The AER's restricted access to contract information has limited our ability to proactively monitor recent key market risks as the current energy crisis has unfolded. The lack of visibility of generators' fuel supply, their ability to access additional fuel and their hedge positions has made assessing market events and participant behaviour incredibly challenging. For example, we would like to be able to consider whether a market participant is 'long' or 'short' in generation and if they have an incentive to push prices up or down, and whether this is done from a whole of portfolio perspective based on the variety of assets owned by that participant.

This has also made it very difficult to understand the impacts that market events were having on individual participants. We have heard from some smaller retailers that they are having trouble accessing contracts because it's hard to find a counterparty that will trade with them.

⁴ ACCC, 2018, Retail Electricity Pricing Inquiry—Final Report, www.accc.gov.au/publications/restoring-electricity-affordability-australias-competitive-advantage

⁵ AER, 2020, Wholesale electricity market performance report, www.aer.gov.au/wholesale-markets/performance-reporting/wholesale-electricity-market-performance-report-2020

AER, 2018, Wholesale electricity market performance report, www.aer.gov.au/wholesale-markets/performance-reporting/aer-wholesale-electricity-market-performance-report-2018

We cannot verify the extent of this risk to small retailers, and it hampers our ability to understand financial risks in the retail sector and the outlook for retail competition.

The AER therefore strongly supports expanding the scope of the electricity market monitoring functions to include contract markets as recommended in the consultation paper. The ability to monitor contract markets would also enhance our ability to set the DMO as it would enable us to get a clearer picture of the true costs to retailers of managing their wholesale market risk. This would better protect consumers against unreasonably high prices and would better ensure that retailers are able to recover their costs.

Expanding the wholesale market monitoring role to gas markets

The AER does not have a monitoring and reporting role, equivalent to the monitoring and reporting role for wholesale electricity markets, for the east coast gas markets⁶. As highlighted in the consultation paper, this lack of a comprehensive market monitoring and reporting framework in the NGL represents a clear regulatory gap.

We agree that providing the AER with a general function to monitor and report on gas wholesale markets would provide information critical to assessing the effectiveness of competition and efficiency in these markets. It would also help us to further understand the extent of the interactions between gas and electricity markets and strengthen our electricity market performance monitoring. This function would allow the AER to monitor and report on the impact of a wide range of gas market reforms as they are implemented and consider the impacts of developments in international markets.

Like the case for electricity, this expanded gas monitoring and reporting role should also include contract markets. The limitations of not having access to gas contract information were exposed during the recent energy crisis. While the AER does not have a comprehensive gas market monitoring role, we do have a function to report on defined price event outcomes. Our ability to fulfil this role is compromised without the power to monitor the contract market. For example, access to contract information would have assisted the AER to better understand the dynamics behind why gas flowed north during May as southern storage was depleted coming into winter. The recent failure of a medium-sized gas retailer was driven by its exposure to higher than projected wholesale gas prices that could not be passed onto its customers. With a better understanding of the nature of various retailer business models, including the extent they were hedged, we would have understood the impacts high spot prices were having and been in a better position to advise policy makers, other market bodies, or relevant jurisdictions. The importance of having this contract information is also vital as the AER assumes new responsibilities. The AER will assume the role of monitoring further short-term contracts from December 2022, and then take over long-term gas contract price reporting in 2025 at the conclusion of the ACCC's gas inquiry.

For the AER to effectively fulfil these functions, changes to the NGL will be required to include an equivalent market monitoring function for gas supported by gas contract market monitoring powers.

⁶ Including also the Gas Supply Hub Exchange (Wallumbilla and Moomba) and the Pipeline capacity trading markets

The AER is mindful of stakeholder concerns about regulatory compliance costs and understands that the current market conditions are challenging for market participants. However, we consider these reforms to the AER's market monitoring and reporting roles as outlined in the consultation paper and in this submission are critical to provide confidence that wholesale electricity and gas markets are operating in the interests of energy consumers. We will work with market participants to develop systems for reporting and information collection that minimise these costs. We will consider whether existing systems can be modified or if, for example, information can be collected directly from contract trading exchanges or other regulators like the Australian Securities and Investments Commission.

If you require further information please contact Gavin Fox, (A/g) General Manager Market Performance Branch, gavin.fox@aer.gov.au.

Yours sincerely

A handwritten signature in grey ink, appearing to be 'CS', with a long horizontal stroke extending to the right.

Clare Savage
Chair

Sent by email to energyministers@industry.gov.au on: 25.08.2022