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Department of Climate Change, Energy, the Environment and Water



Submitted online

PEMM Act Review

The Australian Financial Markets Association (AFMA) is responding to the Department of Climate Change, Energy, the Environment and Water's (DCCEEW) Review of the effectiveness of the *Prohibiting Energy Market Misconduct* (PEMM) Act.

AFMA is the leading financial markets industry association promoting efficiency, integrity and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our membership base is comprised of over 130 of Australia's leading financial market participants, including many energy firms who are key participants in the NEM.

Key Points

- **The concerns the PEMM Act was intended to address are better dealt with by other regulation**
- **The PEMM provisions have been ineffective and should be repealed**
- **The ACCC's Electricity Pricing Inquiry should conclude as scheduled in 2025**

The PEMM Act is part of a series of reforms developed following the ACCC's 2017 Retail Electricity Pricing Inquiry that were designed to lower retail electricity prices by targeting behaviour in the wholesale market. AFMA's view is that the PEMM Act has had little or no impact on market conduct or retail prices and that other reforms, including the Default Market Offer (DMO) and Market Liquidity Obligation (MLO), have been more effective and largely removed the need for the PEMM Act.

AFMA has observed a recent trend of policy makers introducing new regulatory obligations that overlap with existing obligations. This practice leads to increased compliance costs for market participants without delivering clear benefits. We therefore appreciate that this review offers an opportunity to rationalise the regulatory framework.

We are not aware that the ACCC has used the PEMM Act powers to achieve any meaningful improvements for consumers and consider that introducing the ACCC into areas already regulated by the AER and ASIC has confused the regulatory architecture. We therefore think it is appropriate for the provisions to be repealed.

1. Retail Market Prohibitions

The retail market prohibitions were designed to ensure electricity retailers passed on any substantial reductions in the underlying cost of procuring electricity to supply small customers. They were developed at a time when price regulation did not apply to most small customers in the NEM and where electricity prices were temporarily elevated and expected to decrease. The utility of these provisions in a competitive de-regulated market was unclear, but since the re-introduction of retail price regulation with the DMO and related Victorian Default Offer we do not consider that there is any role for them.

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In the retail electricity market, it is the role of the AER to determine a regulated safety net price for small customers who do not engage in the market. Under the DMO (and other state price regulation arrangements) regulated retail prices are determined 12 months in advance using a building block approach to determine the efficient costs for a retailer to supply small customers. These costs include regulated network tariffs and the wholesale cost of energy, and a much smaller contribution from retailers cost to serve its customers. Given that the network costs are essentially a regulated pass through for retailers and that retail costs are already modest, the only real component that could deliver a substantial reduction in costs for retailers, is the wholesale market cost.

AFMA's observation is that it is unlikely that there will be a substantial reduction in wholesale costs between the time that the regulator determines prices and the end of the year the prices apply to. The energy financial market is always forward looking with limited activity in the current year and most liquidity in future years. This is partly a result of energy retailers looking to lock in their wholesale cost of energy before the beginning of the regulatory period to ensure they are able to profitably supply customers on regulated tariffs. As a result, the regulator will generally have a fairly accurate view of the cost of energy for the relevant regulatory period and it is unlikely that this will change substantially during the period. If wholesale costs for future years decrease the regulator can then incorporate these decreases into their future decisions to share the benefit with customers.

2. Electricity financial contract market prohibitions

The electricity financial contract market prohibitions were intended to prevent generators from discriminating against retailers by refusing to offer hedge cover on competitive terms. AFMA considers that these provisions are unnecessary as dealing in electricity financial products is already subject to equivalent regulation under Part 7.10 of Chapter 7 of the *Corporations Act* or the general provisions of the *Competition and Consumer Act*.

The PEMM Act provisions were intended to improve market liquidity by making it easier for retailers to access financial hedging products. These provisions do not appear to have had any impact on liquidity in illiquid markets, particularly South Australia. While these provisions have had no impact on liquidity another policy intervention that occurred at a similar time to the PEMM Act has had a material impact on retailers' ability to access hedge cover in illiquid markets. The Market Liquidity Obligation (MLO), which was introduced as part of the Retailer Reliability Obligation (RRO), imposes mandatory market making obligations on large generators in illiquid regions. While AFMA's members are critical of the RRO in general they have found the MLO has improved liquidity in illiquid regions.

AFMA considers that the PEMM Act's electricity financial contract market prohibitions have not been effective in increasing liquidity while the MLO has been. We consider the PEMM provisions should be repealed as they are ineffective and duplicate existing obligations. We also note that the AER now has new powers to monitor the wholesale market which may help with market transparency.

3. Electricity spot market prohibitions

As with the financial contract market provisions, AFMA does not consider that the spot market prohibitions are necessary as they substantially duplicate provisions of the National Electricity Rules (NER) and create confusion between the roles of the AER and ACCC. Our view is that spot market conduct provisions should be located in the NER and enforced by the AER. We therefore consider that the PEMM Act provisions should be repealed.

4. ACCC NEM Inquiry Function

Policy makers have introduced a number of new energy market transparency measures recently. While AFMA appreciates the value of increased market transparency and well-informed regulators we

have been concerned that the multiple new measures have resulted in substantial overlap between the information collected by AEMO, the AER and the ACCC, leading to increased costs for the market participants, which are ultimately recovered from customers.

In previous submissions AFMA has encourage policy makers to coordinate the various information gathering powers to reduce costs for market participants and regulators,¹ we therefore support concluding the Electricity Pricing Inquiry as scheduled in 2025. AFMA considers that this timing is appropriate as the AER is now in the process of implementing its new wholesale market monitoring powers which will see it perform a similar role to the ACCC's inquiry on an ongoing basis. We consider that with the commencement of the AER's new functions there is no ongoing need for the ACCC's inquiry, and it should not be extended.

AFMA Recommendations

- i. The PEMM Act should be repealed.
- ii. The ACCC's Electricity Pricing Inquiry should not be extended.

AFMA would welcome the opportunity to discuss this submission further and would be pleased to provide further information or clarity as required. Please contact me at lgamble@afma.com.au or 02 9776 7994.

Yours sincerely,



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¹ [Joint AFMA/ AEC Wholesale Market Monitoring and Reporting Reforms Submission](#)