



Senate Standing Committees on Economics

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4 October 2019

### **Inquiry into the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019**

AGL Energy Limited (**AGL**) welcomes the opportunity to make a submission to the Economics Legislation Committee (the **Committee**) on the provisions of the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 (the **Bill**).

AGL notes that the Bill was previously introduced into Parliament in 2018 as the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018 (**2018 Bill**) and was referred to the Committee for inquiry and report on 18 March 2019. The Government then took the Bill as a policy position to the federal election, and has now sought to implement this policy by the passage of the Bill. AGL has sought to work constructively with the Government to improve the drafting of the Bill with a view to making it clearer, more certain in its application and therefore reducing the risks of perverse outcomes for consumers and the NEM more generally. It is in this spirit that AGL makes this further submission to the Committee.

AGL welcomes the amendments made in response to engagement with industry. Most of AGL's substantive concerns with the Bill remain however, and we have therefore annexed to this submission AGL's submission to the Committee regarding the 2018 Bill dated 25 January 2019 for your consideration. AGL remains concerned that the Bill, in its proposed form, creates significant uncertainty and therefore creates a risk of unintended consequences including that of discouraging investment and increasing compliance costs. AGL also refers to the Australian Energy Council's (**AEC**) submission to the Committee and supports the comments made and amendments suggested in that submission. AGL also supports the views expressed in the submission from the Business Council of Australia (**BCA**). AGL considers the changes suggested below (which align with those suggested by the AEC and BCA) will mitigate this risk.

#### ***Changes to the Bill following its previous introduction in 2018***

AGL notes that the Bill contains some amendments to the 2018 Bill which can be summarised as follows:

- Schedule 1 of the Bill, which contains the new prohibitions to be introduced into the *Competition and Consumer Act 2010 (Cth)* (**CCA**), will take effect 6 months after Royal Assent, giving the ACCC time to prepare enforcement guidelines and electricity companies additional time to prepare for compliance;
- clarification that personal liability for the prohibited conduct in the Bill will attach only to directors, secretaries or senior managers (section 153ZD); and
- clarification that the retail pricing prohibited conduct in section 153F does not apply to standing offers, which are subject to retail electricity reforms that came into effect on 1 July 2019 in NSW, South Australia and south-east Queensland pursuant to the *Competition and Consumer (Industry Code –*



*Electricity Retail) Regulations 2019* (Cth), and does not require retailers to make an adjustment that would be in contravention of another law.

While AGL welcomes these amendments, which have come as a result of constructive engagement between the industry, Treasury and the Department of the Environment and Energy (the **Department**), AGL does not believe they address the flaws in the Bill identified by AGL in its January 2019 submission. These flaws were also identified by numerous other stakeholders, both in submissions and during the two public hearings held by the Committee in February 2019.

### ***Key concerns in relation to the Bill***

AGL remains particularly concerned in relation to the following provisions in the current form of the Bill:

- ***conferring inappropriately broad and discretionary powers on the Treasurer.*** Division 5 - subdivision A of the Bill empowers the Treasurer to make contracting orders that directly interfere with contractual matters between private businesses if the Treasurer is satisfied that the relevant prohibited conduct has been engaged in by a corporation. The Treasurer will have the power to dictate the kinds of electricity financial contracts that must be offered, at what price and the number of megawatt hours of electricity that the contracts relate to. This represents a significant intrusion into private contractual rights and agreements in the electricity market, in circumstances where there has been no judicial process or finding of a breach of the provisions. Further, the Treasurer is under no specific obligation to consult with the relevant business before making a contracting order, nor is there a specific obligation on the ACCC to consult before it recommends to the Treasurer that a contracting order should be made. The unprecedented nature of these powers coupled with the lack of procedural fairness will create risks and uncertainty for electricity businesses as they contract and manage their hedge books, and undermine a business' ability to implement legitimate risk management strategies that are cost effective and efficient;
- ***introducing an electricity spot market prohibition that risks undermining the design premise of the NEM.*** Sections 153G and 153H seek to prohibit certain bidding and failing to bid conduct that distorts or manipulates prices. The basic design and function of the NEM, which employs an auction-based clearing mechanism, results in effectively all bids (or withheld bids) impacting the spot price in the market. Further, high prices in the spot market are intended to legitimately provide signals for investment in new capacity. It is unclear how the prohibitions will clearly draw a line between legitimate bidding (or not bidding), which is central to the design of the electricity market, and prohibited conduct. Any attempt to apply these provisions in a manner that undermines the fundamental premise of the NEM will be detrimental to the long-term efficiency of the market and deter new investment; and
- ***introducing a broad retail pricing prohibition that uses very general language of uncertain application.*** A retailer will contravene the retail pricing prohibition in section 153F if it fails to make "reasonable adjustments" to the price it supplies or offers to supply to reflect sustained and substantial reductions in its "underlying cost of procuring electricity". While the provision has been amended to clarify that it does not apply to standing offers, the amendments do not address the critical problems of interpretation and application brought about by the drafting. For example, the concept of "substantial" and "sustained" reductions is subject to important definitional issues and the Explanatory Memorandum (**EM**) offers little practical guidance to market participants as to how that will be determined.

As the ACCC itself has acknowledged, the Bill does not implement specific recommendations from the Retail Electricity Pricing Inquiry Final Report and raises "complex new issues of application".<sup>1</sup>

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<sup>1</sup> ACCC, *Inquiry into the National Electricity Market – August 2019 Report*, 20 August 2019, p36.



While the ACCC will in due course produce enforcement guidelines, these guidelines should not be relied upon to resolve all the complex issues raised by the drafting of the Bill and the new forms of prohibited conduct. Industry will seek to work constructively with the ACCC on these guidelines, but AGL is firmly of the view that amendments to both the Bill and the EM are a more appropriate and effective way of providing greater clarity and mitigating compliance risks.

#### ***Developments since the Bill was first introduced***

AGL further notes that there have been significant policy developments since the Bill was first introduced into Parliament that should be considered by the Committee. These are summarised below:

- retail electricity pricing and advertising reforms that came into effect on 1 July 2019 in NSW, South Australia and south-east Queensland with the introduction of the default market offer (**DMO**) pursuant to the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019* (Cth), and in Victoria with the implementation of the Victorian Default Offer (**VDO**). The DMO and VDO reforms were directly aimed at delivering lower electricity prices to customers who do not engage with the competitive market. In its most recent report as part of the seven-year inquiry into the National Electricity Market (**Electricity Inquiry**), the ACCC acknowledged that while it is very early days, it noted that post 1 July 2019, standing offer prices for many customers have fallen, often significantly, with retailers moving to plan structures which enable customers to more easily identify a better deal and gain the benefits of competition.<sup>2</sup> AGL reiterates the point made in the AEC's submission that neither the ACCC nor the AEMC have expressed a view that market offers are not providing efficient prices to customers; and
- the Energy Security Board (**ESB**), has commenced its 'Post 2025 Market Design' work at the request of the COAG Energy Council to advise on a long-term, fit-for-purpose market framework.

#### ***Proposed amendments to the Bill***

We note that the AEC and the BCA have both provided the Committee with the proposals that it put forward to the Government. AGL is of the view that either proposal or some combination of both proposals would present a marked improvement to the current drafting of the Bill.

In particular, the key amendments that would provide clarity to the industry and attempt to mitigate the risks to investment that the Bill is likely to create are:

- **Contracting order** – amending sections 153W and 153X so that the Treasurer applies to the Federal Court for a contracting order, which the Court can make if the Court is satisfied that the prohibited conduct in sections 153F or 153H has been engaged in by the relevant corporation and that the contracting order is a proportionate means of preventing the corporation from engaging in that kind of prohibited conduct in the future.
- **Bidding prohibited conduct (basic and aggravated cases)** – amending sections 153G and 153H to clarify that a corporation does not contravene these provisions by engaging in bidding conduct that is consistent with, or bidding that results in price outcomes or benefits obtained through electricity financial contracts that would be expected having regard to, the design of the NEM. Recognition of the design of the NEM is set out in the EM and this amendment would simply incorporate language already set out in the EM.
- **Retail pricing prohibited conduct** – section 153E should be amended so it is clear that the underlying cost of procuring electricity is to be determined by reference to whether there has been a reduction in the industry benchmark costs, being the costs that would be incurred by a prudent and efficient standalone



retailer in managing the risks of supplying customers in the relevant market, followed by a consideration of whether there are specific circumstances applying to the retailer. The concept of a standalone efficient retailer is one that is relatively well understood in regulated pricing processes.

AGL also believes that all stakeholders, including industry and the ACCC, would benefit from further consultation specific to the EM, even in the absence of further amendments to the Bill. AGL notes that there are a number of issues that appear to be the subject of agreement between Government and industry in respect of how the Bill is intended to operate, but these have not been clearly articulated in the EM at this time. Further effort should be made to incorporate these changes wherever possible to assist with the efficient and effective implementation of the Bill.

AGL would welcome the opportunity to further address the matters raised in this letter and the annexed submission.

Yours sincerely,

Beth Griggs  
**General Manager – Competition Regulation & Strategy**



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**25 January 2018**

Dear Senate Standing Committees on Economics

**AGL submission to Senate Standing Committees on Economics Inquiry into the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018**

AGL Energy Limited (**AGL**) appreciates the opportunity to set out our response to the Legislation Committee of the Senate Standing Committee on Economics (the **Committee**) Inquiry into the provisions of the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018* (the **Bill**).

AGL does not believe the Bill provides an effective means of addressing the root causes of increases in energy prices, which are largely attributable to the withdrawal of ageing generators from the NEM and a tightening in supply and demand. The Australian energy sector is transitioning from a system dependent on aging thermal fleet to one characterised by lower emission technologies. It is commonly accepted that in order to achieve this transition and ease the current pressure on wholesale prices, the Australian market requires significant amounts of capital to be invested.

In contrast, the Bill is likely to delay investment and in doing so both exert upwards pressure on electricity prices and also degrade system security. It does this by significantly increasing the risks for both retailers and generators in respect of their everyday operations. The Bill imposes new, highly uncertain conduct provisions on all generators and retailers coupled with some extreme and arbitrary penalties. These conduct provisions are in no way responsive to issues identified by the Australian Competition and Consumer Commission (**ACCC**) as key priorities for energy market reform. And the Bill does this in an environment already characterised by very high levels of regulation.

This Bill will not result in sustained lower prices for consumers. It risks having the opposite effect.

**AGL supports policy reform that addresses identified issues and drivers of increased prices**

Proudly Australian, with more than 180 years of experience, AGL operates Australia's largest electricity generation portfolio, is the largest ASX-listed investor in renewables and currently has 3.6 million customer accounts. AGL takes our responsibility to provide sustainable, secure and affordable energy for our customers as our central obligation.

We recognise that despite some recent price reductions, high energy prices are having a significant impact on households and businesses, and that our customers' concerns with these cost pressures need to be considered alongside those of energy security and environmental sustainability. AGL accepts the level of concern expressed in the ACCC Retail Electricity Inquiry Final Report (June 2018) in respect of energy prices, particularly for those customers who do not access the competitive market, and the lack of transparency and comparability of energy offers faced by consumers who are seeking to engage with the competitive market.



We have already acted to reward loyal customers on standing contracts with up to a 10 per cent reduction to their offer, and are currently investing more than \$2 billion directly and indirectly in new supply to help provide the capacity the energy system needs.

AGL is actively supporting a number of initiatives designed to move the industry quickly towards enhanced levels of transparency and comparability of energy offers, such as the initiative to establish a voluntary comparison rate for retail electricity prices, which was announced by the Minister for Energy following the round table with energy retailers on 7 November 2018. We are also supportive of the recent work by the Australian Energy Regulator (**AER**) in developing easier means of comparison, including the development of a benchmark price for comparison purposes.

**The Bill risks deterring investment, exerting upward pressure on prices and impacting system security**

AGL does not support this Bill, as AGL does not believe it provides an effective means of addressing the root causes of increases in energy prices. Both the ACCC and the AER in recent reports have identified the withdrawal of significant blocks of low priced generation capacity from the NEM, and increases in gas and coal costs, as key drivers of recent uplifts in prices. As noted by the AER:

*The market is undergoing a significant transformation. The NEM is transitioning to a lower emissions generation mix. Significant coal capacity has retired from the market and further plant closures are expected in the future. Meanwhile the share of generation from intermittent renewable sources has increased rapidly in recent years and more is on the horizon. Over time, this transformation will change market dynamics, with fast response 'flexible' generators, demand management and storage likely to have an increasing role...<sup>1</sup>*

The AER then proceeded to comment on the need for policy stability to support the investment necessary to exert downward pressure on prices:

*... , we do consider the lack of consistent policy signals to support investor confidence is one of the biggest threats to competition and efficiency in the NEM over the long term. While achieving this policy environment will be a significant challenge, it is very important if we are to continue to rely on market signals to deliver an effectively competitive wholesale electricity market.<sup>2</sup>*

As detailed in the attached submission, AGL is concerned that not only does the Bill not positively address the need for policy certainty and investment, it will in fact degrade the investment environment in the NEM. This not only has the potential to exert upward pressure on wholesale prices, but also to have a deleterious effect on system security and reliability across the NEM.

Changes to the regulatory regime applicable to the NEM have always been developed through an extended and comprehensive consultation process – by contrast, the process for the current Bill has not included any meaningful consultation with industry, regulators, the Council of Australian Governments Energy Council (COAG EC) or the Australian community. AGL notes that the energy sector is already subject to extensive regulation under the National Electricity Law and Competition and Consumer Act 2010 (Cth), and that very few of the provisions in the Bill have any relationship with recommendations made by the ACCC, AER or the AEMC. Some provisions in the Bill directly conflict with current COAG EC processes.

AGL therefore asks the Committee to take the time to fully and comprehensively examine the Bill and its potential consequences.

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<sup>1</sup> AER, Wholesale electricity performance report December 2018, page iv.

<sup>2</sup> AER, Wholesale electricity performance report December 2018, page v.



AGL would welcome the opportunity to further address matters raised in the attached submission.

Yours sincerely,

Beth Griggs  
**General Manager - Competition Regulation & Strategy**



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## 1. Executive summary

AGL's principal concerns can be summarised under the following 6 themes, which are described in more detail throughout this submission:

- **The Bill does not address the cause of higher retail prices or the other problems identified in the ACCC's Final Report and is likely to result in delays to investment which will impose upward pressure on electricity prices and degrade system security.** The ACCC and AER, have clearly identified the primary drivers of current high prices as the imbalance of supply and demand in the wholesale market due to withdrawal of aging thermal capacity, lack of investment in new capacity and increasing generation fuel costs. In the retail market, the ACCC identified consumer confusion caused by a lack of transparency and comparability in retail prices as a key issue requiring reform. AGL is concerned that not only does the Bill not positively address the need for policy certainty and investment, it will in fact degrade the investment environment in the NEM. This not only has the potential to exert upward pressure on wholesale prices, but also to have a deleterious effect on system security and reliability across the NEM.
- **The provisions of the Bill are unclear and likely to be uncertain in operation. A number of the key provisions use broad, vague and inadequately-defined concepts.** The Bill is therefore inherently subjective and complex, and open to multiple interpretations. The uncertainty of the Bill creates vague obligations and market participants will be unable to determine what is required in order to comply with its provisions. In addition, some of the key provisions regarding the enforcement of contracting orders and the power to order divestment appear to offend clear Constitutional principles and are likely to result in complex and costly legal challenges if they are enforced. These issues are dealt with in more detail in part 3 below.
- **The Bill confers power on the AER to issue legislative instruments which are not subject to the usual forms of judicial or merits review and which are not amenable to disallowance by Parliament.** This is an unusual and draconian approach to decision making and one which is more usually reserved for the arenas of Ministerial level decisions concerning national security or intelligence matters. The introduction of the power would appear to be in an effort to prepare the ground for some form of retail price control, but the power is not so confined (see further part 4 below).
- **The uncertainty of the Bill confers inappropriately broad discretionary powers on the relevant regulators.** It will be difficult for market participants to predict how regulatory powers will be exercised by the ACCC and the Treasurer. The breadth of the discretions being conferred renders those powers liable to be exercised in an arbitrary manner or in aid of short term extraneous objectives. There is a real risk that the Bill will deter investment because of the punitive consequences that may follow the exercise of regulatory powers by the ACCC and the Treasurer (see further part 5 below).
- **The Bill lacks procedural fairness and provides inadequate scope for review.** This is particularly concerning given the draconian remedies under the Bill. The risks to investment identified in part 5 are compounded by the Bill's failure to provide for any effective merits review of the exercise of key powers and discretions (see further part 6 below).
- **The existing regulatory landscape (in particular the NEL and the CCA) already deals sufficiently with the type of anti-competitive conduct targeted by the Bill.** The introduction of an additional regulatory regime runs the risk of creating overlapping and conflicting obligations with the existing regulatory landscape. This is described in more detail in part 7 below.

AGL submits that given the significant uncertainty of its key provisions, the lack of procedural fairness and failure to provide for any proper review of decisions, and the disproportionate and arbitrary nature of the available remedies, the Bill will – **even if these new laws are never used** – significantly reduce investment incentives in the electricity sector, particularly investment in new large-scale dispatchable generation capacity. The broad and uncertain obligations imposed by the Bill must be considered in the context of the



types of business decisions that it addresses. Electricity market participants make offers and bids to supply electricity hundreds of times a day; they are not rare decisions. AGL is concerned that the effect of imposing uncertain and indeterminate new norms of conduct in such a context will be disruptive and counter to the very objectives the Bill seeks to achieve.

As noted above, AGL considers that the consultation process for the Bill has been wholly inadequate. The Regulation Impact Statement for the Bill (**RIS**) was not the subject of any meaningful consultation and is not based on input or feedback from any industry participant.<sup>[1]</sup>

AGL urges the Committee to take the time to examine the Bill and its potential consequences thoroughly. AGL has put a number of its concerns in its previous submissions (see the Chronology of events in part 2.2 below). Copies of those submissions are **enclosed** for the Committee's reference.

## 2. Overview of the Bill: Key provisions

The Bill would amend the CCA to introduce:

- four new prohibitions concerning:
  - an electricity supplier's failure to make "reasonable adjustments" to the price of electricity offers or supplies to reflect "reductions in its underlying cost of procuring electricity" – section 153E;
  - where an electricity generator (or related body corporate) "fails to offer", "limits or restricts its offers", or makes offers in a way that has the effect of "preventing, limiting or restricting acceptance" of offers for the purpose of substantially lessening competition "in any electricity market" – section 153F; and
  - so-called "basic" (section 153G) and "aggravated" (section 153H) prohibited conduct in an electricity spot market, comprising making bids or offers to supply electricity, or failing to bid or offer to supply electricity for the purpose of "distorting or manipulating prices" in that market, and/or doing so "fraudulently, dishonestly or in bad faith";  
**(new prohibitions).**
- new remedies for contraventions of the new prohibitions, including:
  - public warning notices (section 153M) and infringement notices (section 153N) issued by the Australian Competition and Consumer Commission (**ACCC**) under Division 3 (**ACCC's orders**);
  - in respect of alleged breaches of sections 153F and 153H, contracting orders issued by the Treasurer under Division 5 (**contracting orders**); and
  - in respect of alleged breaches of section 153H, divestiture orders made by the Court upon application by the Treasurer under Division 6 (**divestiture orders**).
- broader powers for the Australian Energy Regulator (**AER**) to make legislative instruments – section 44AH (**AER legislative instrument-making power**).

The Explanatory Memorandum for the Bill (**EM**) also notes that Treasurer issued price caps may be introduced in future.<sup>3</sup> That remedy would allow the Treasurer to order that a corporation's retail electricity offers are capped at the level of the default market offer. AGL anticipates that the AER may set the relevant

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<sup>[1]</sup> EM, [8.1]-[8.144].

<sup>3</sup> See EM, [8.47].



default market offer under the new AER legislative instrument-making power, and that no further legislative amendment beyond the proposed section 44AH would be required in order to do this.

Accordingly, the Bill lays the groundwork for the reintroduction of *de facto* retail price regulation through that remedy. However, unlike previous forms of retail price regulation in the energy sector the decisions of the AER will effectively be unreviewable, as the Bill proposes to allow the AER to regulate through the use of legislative rather than administrative instruments.



### 3. The consultation process for the Bill has been inadequate

*AGL urges caution and restraint in amending the legal framework for the regulation of economic activity in the energy sector.*

*AGL considers that the consultation process for the Bill has been inadequate and bypasses the established processes and channels for reform in the energy sector.*

*In preparing its Report, the Committee should closely consider this clear and calculated attempt to limit the opportunity for review, and for consultation more broadly.*

#### 3.1. Importance of a genuine consultation process

Any legislative amendments relating to the energy needs of Australians need to consider an extensive body of research, data and analysis, the outcomes of numerous previous inquiries and reviews into the energy sector and importantly, to engage key industry stakeholders in consultation and debate.

Further, regard must be had to the COAG energy agreements and to decades of cooperative and iterative changes to Australia's electricity sector by agreement between the States and Commonwealth, in consultation with the industry and regulators. Indeed, the Australian Energy Market Agreement (as amended December 2013) (**AEMA**) unequivocally provides that amendments to energy policy and governance should only be made in consultation with COAG.<sup>4</sup>

Historically, the process of reform of major economic laws by the Commonwealth and COAG has been undertaken in a careful and deliberative manner. For example, the Final Report of the Competition Policy Review delivered in March 2015 (**Harper Review**) was subject to extensive and lengthy consultation.

AGL notes and endorses the following principle set out in "Ten Principles for Australian Government Policy Makers": "*Policy makers should consult in a genuine and timely way with affected businesses, community organisations and individuals.*"<sup>5</sup>

While the Bill follows the ACCC's Retail Electricity Pricing Inquiry Final Report (**Final Report**), its content goes far beyond the recommendations of that report. And, unlike the Harper Review, that report was prepared by a regulator rather than an independent panel which undertook a highly collaborative review process.

AGL considers a similarly extensive consultative process should have been adopted for the Bill to ensure any reform is fit for purpose. This is precisely because economic laws can have profound and unintended consequences causing damage to the economy and to the public interest.

#### 3.2. Chronology

A chronology of key events leading to the introduction of the Bill into Parliament, AGL's response during this process, and next steps is set out in the table below:

<b>29 June 2018</b>	The ACCC issues its Final Report.
<b>23 October 2018</b>	The Treasury issues an <i>Electricity price monitoring and response legislative framework Consultation Paper</i> ( <b>Consultation Paper</b> ).
<b>8 November 2018</b>	AGL makes a submission in response to the Consultation Paper ( <b>8 November Submission</b> ).

<sup>4</sup> See AEMA, clauses 4.1- 4.3 and 6.6-6.8.

<sup>5</sup> *The Australian Government Guide to Regulation*, Department of Prime Minister and Cabinet, Canberra, 14 March 2014.



<b>16 November 2018</b>	The exposure draft of the <i>Treasury Laws Amendment (Electricity Price Monitoring) Bill 2018 (Draft Legislation)</i> was provided to AGL on a confidential basis.
<b>22 November 2018</b>	AGL makes a submission in response to the Draft Legislation ( <b>22 November Submission</b> ).
<b>5 December 2018</b>	The Bill is introduced to Parliament. It is in substantially amended form from the Draft Legislation provided in November 2018.
<b>6 December 2018</b>	The Senate refers the Bill to the Committee.
<b>25 January 2019</b>	Date by which submissions to the Committee must be made. (AGL notes that the submission date was changed from the original date of 11 February 2018).
<b>18 March 2019</b>	Date for the Committee's inquiry and report on the Bill.

### 3.3. AGL's concerns with the consultation process for the Bill

AGL is deeply concerned that the consultation process for the Bill is inadequate and bypasses the established processes and channels for reform in the energy sector, particularly given the following.

- The timeline between 23 October (release of the Consultation paper) and the introduction of the Bill on 5 December 2018 was very short. However that period overstates the actual opportunities to provide comment on the policy direction and the Bill. The Draft Legislation was subject to very limited circulation and AGL had only 7 days to provide comments on the Draft Legislation notwithstanding its complexity and that it included provisions that were not meaningfully foreshadowed by the Consultation Paper.
- The periods to respond to the Consultation Paper and Draft Legislation were unusually short and entirely insufficient for meaningful comment on draft legislation of such importance and complexity. The industry has not been provided with any cogent policy reasons for the unusually short timeframe for stakeholder engagement on the Consultation Paper or Draft Legislation.
- The process also lacked sufficient public transparency and consultation. Treasury has not published submissions on the Consultation Paper or the Draft Legislation. AGL is concerned that this has inhibited public debate and limited the usual democratic process.
- The Bill was introduced without COAG consultation or agreement, which undermines the COAG agreements, and is profoundly contrary to the public interest. Indeed, the Commonwealth has itself previously criticised the States for seeking to take unilateral action that would affect energy markets (in the context of renewable energy targets).<sup>6</sup>
- In particular, the proposed retail price measures (section 153E and the new powers conferred on the AER by Schedule 2) would effectively abrogate the States' jurisdictional power over retail prices. The States are currently consulting in accordance with resolutions of the COAG on the introduction of a default retail price, and have requested that the AEMC advise them on the effect such regulation would have on competition. As noted in the 21st Meeting Communique of the COAG held on 19 December 2018: "*Ministers noted the states' and territories' position that Commonwealth legislation should not be used to set reference prices or otherwise regulate electricity pricing without the agreement of the*

<sup>7</sup> COAG Energy Council 20th Meeting Communique, 19 December 2018:  
<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/21st%20COAG%20Energy%20Council%20Communique.pdf>



*relevant jurisdiction.*<sup>7</sup> The Bill would render such consultation redundant, and will give the Commonwealth significant control and discretion over retail price setting.

- Even though only a limited and inadequate consultation process occurred, the concerns raised during that process were not adequately addressed in the Bill. Further, the Bill includes a whole suite of new provisions which were not subject to consultation.
- The RIS is wholly inadequate. As it notes, “*the broader economic costs and benefits associated with the legislation have not been quantified*”.<sup>8</sup> On the basis of a narrow and unrealistic estimate of the regulatory cost burdens imposed by the Bill, the Treasury has self-assessed the regulatory costs and not consulted with any parties likely to be affected.<sup>9</sup>
- Finally, the process has been insufficient given the sheer complexity of the energy market and the applicable regulatory regimes. The regulatory framework for the NEM is well-developed, highly complex and effective. Accordingly, the AEMC has established an extensive process for considering and consulting on rule changes to prevent unintended consequences such as inefficient market operation and negative flow-on impacts to consumers, businesses and investment incentives.<sup>10</sup>

These concerns are potential damaging given that the Commonwealth is seeking to unilaterally and fundamentally alter the regulation of Australian energy markets, and intends in future to introduce *de facto* retail price regulation.

By way of contrast, in 2016 the Committee reported on the *Competition and Consumer Amendment (Misuse of Market Power) Bill 2016*. That bill introduced similarly complex concepts into the CCA, being the introduction of the “effects test” for misuse of market power, with similarly important ramifications for Australian markets.<sup>11</sup> In its report, the Committee stated:

*The reforms to section 46 of the CCA have been the subject of very extensive stakeholders consultation and public debate, through the Harper Review as well as subsequent discussion paper and exposure draft consultations.*

*[The Harper review] undertook extensive consultation with businesses, consumers and other industry stakeholders.*<sup>12</sup>

The Committee also commented on the Government’s response to the Harper Review which stated that:

*The Government acknowledged the concerns raised throughout the review process regarding the operation of the misuse of market power provision and, given the importance of the issue for affected stakeholders, committed to consult further on options to reform the provision.*<sup>13</sup>

For the reasons above, the same cannot be said of the consultation process for the current Bill. Nor does the Bill follow a comprehensive independent review like the Harper Review – indeed, the ACCC Final Report explicitly rejected the introduction of the centrepiece “big stick” divestiture powers that remain in the current Bill (see further part 6.4 below).

<sup>7</sup> COAG Energy Council 20th Meeting Communique, 19 December 2018:

<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/21st%20COAG%20Energy%20Council%20Communique.pdf>

<sup>8</sup> EM, [8.121].

<sup>9</sup> EM, [8.122].

<sup>10</sup> See <https://www.aemc.gov.au/our-work/changing-energy-rules>

<sup>11</sup> See Senate Committee Review Paper on *Competition and Consumer Amendment (Misuse of Market Power) Bill 2016* page 1.

<sup>12</sup> See Senate Committee Review Paper on *Competition and Consumer Amendment (Misuse of Market Power) Bill 2016* pages 3 and 22.

<sup>13</sup> See Senate Committee Review Paper on *Competition and Consumer Amendment (Misuse of Market Power) Bill 2016* page 4.



## 4. Key provisions of the Bill are highly uncertain

*The Bill creates prohibitions that are not framed by reference to clear, objectively determinable legal standards. Rather, the key operative provisions are drafted with reference to broad, vague and inadequately defined concepts. This is contrary to the rule of law.*

*The length of the EM is an effective acknowledgment of the inherent ambiguity and uncertainty of the Bill – but an EM has only a limited, secondary role in statutory interpretation, and cannot cure legal uncertainty with the primary provision.*

*This lack of clarity will create uncertainty for the industry, regulators, the Treasurer and the Courts as to how the law should apply. Each is likely to have a differing interpretation of the provisions.*

*AGL is concerned that the legal uncertainties will negatively affect the regulatory landscape and investment in the market, because:*

- *retailers and generators will be unable to attribute meaning to the broader provisions with confidence, making compliance difficult or impossible;*
- *the legal uncertainty will create a high degree of discretion in how the prohibitions are interpreted and ultimately with how the remedies are applied; and*
- *the need to modify behaviour in an attempt to comply with the prohibited conduct provisions and avoid the disproportionate remedies will affect electricity businesses and prices both unnecessarily and in unpredictable ways.*

### 4.1. Importance of clear and certain legislation

It is a fundamental principle of the Australian legal system that laws be drafted clearly and with certainty, so that those laws can be interpreted both by those who are subject to them, and those that apply them. This is essential for proper public understanding of laws and regulations, effective compliance and enforcement and – for laws affecting economic activities – efficient market operation and investment incentives.

Relevantly, the Attorney-General's Department notes on its public website that:<sup>14</sup>

*Complex legislation can create uncertainties about the law. This can impose unnecessary burdens on business and restrict the ability of those affected by the law to understand their legal rights and obligations.*

*Laws that are clear and easy to understand are an essential part of an accessible justice system. Clearly written laws can be better understood, complied with and administered.*

Clear laws are imperative in the electricity industry given the number of stakeholders and the impact that competition laws have on the market, economy and investment. The Harper Review stated that competition laws and regulations should be “*clear, predictable and reliable*”.<sup>15</sup>

AGL considers that the Bill, in its current form, lacks sufficient clarity, because a number of its key operative provisions rely on broad, vague and ill-defined concepts as criteria for liability.

### 4.2. Role of the Explanatory Memorandum

While the Bill is accompanied by an unusually lengthy EM, and the EM appears to represent a genuine effort by those responsible for it to grapple with some of the complexities and shortcomings of the Bill, the EM will not cure the uncertainty arising from overbroad and imprecise statutory language.

<sup>14</sup> <https://www.ag.gov.au/LegalSystem/ReducingTheComplexityOfLegislation/Pages/default.aspx>

<sup>15</sup> Harper Review, page 9.



The EM will come into focus if a Court is tasked with resolving a dispute about the meaning of a particular provision of the Bill. If that occurs, a Court may have regard to extrinsic material (such as an EM) in order to:<sup>16</sup>

- confirm that the meaning of a provision is the ordinary meaning conveyed by the text of the provision; or
- determine the meaning of a provision when:
  - the provision is ambiguous or obscure; or
  - the ordinary meaning leads to a result that is manifestly absurd or is unreasonable.

Other extrinsic material (such as the Minister's second reading speech in Parliament and relevant inquiry or law reform reports) may also be used by a Court in resolving specific ambiguities in legislation.

However, none of this material is likely to assist when the fundamental vice of the legislation is the apparently deliberate choice of the broadest possible language and concepts as the criteria for liability and the exercise of discretions by executive decision makers. In such a situation, a Court exercising judicial review of a decision can only perform a very limited role:

*... courts of law have no source whence they may ascertain what is the purpose of the discretion except the terms and subject matter of the statutory instrument. They must, therefore, concede to the authority a discretion unlimited by anything but the scope and object of the instrument conferring it. This means that only a negative definition of the grounds governing the discretion may be given. It may be possible to say that this or that consideration is extraneous to the power, but it must always be impracticable in such cases to make more than the most general positive statement of the permissible limits within which the discretion is exercisable and is beyond legal control.<sup>17</sup>*

An extensive EM is no substitute for clear and well-drafted provisions with objective and unambiguous legal standards.

AGL is concerned that the lack of clarity in the Bill will create uncertainty for the industry, regulators and the Court as to how the law should apply. To illustrate AGL's concerns, AGL considers the legal uncertainty of each of the prohibited conduct provisions in turn below.

#### 4.3. Retail pricing adjustments

##### 153E Prohibited conduct—retail pricing

A corporation contravenes this section if:

- (a) the corporation offers to supply electricity, or supplies electricity, to small customers; and
- (b) the corporation fails to make **reasonable adjustments to the price of those offers**, or to the **price of those supplies**, to **reflect sustained and substantial reductions in its underlying cost of procuring electricity**.

This prohibition has very broad application. It applies to all retailers (whether vertically integrated or not), all electricity supplies and to all offers to supply to residential and small business customers. Further, the prohibited conduct provisions capture conduct of “any related body corporate”.

A retailer will contravene this prohibition if it fails to make “reasonable adjustments” to the price it supplies or offers to supply to reflect reductions in its “underlying cost of procuring electricity”.

The sheer length of discussion in the EM about the interpretation and application of this provision, including 11 separate “examples”,<sup>18</sup> is an effective acknowledgment of the inherent uncertainty and ambiguity of the

<sup>16</sup> *Acts Interpretation Act 1901* (Cth), section 15AB.

<sup>17</sup> *Swan Hill Shire v Bradbury* (1937) 56 CLR 746 at 757-758 per Dixon J.

<sup>18</sup> EM, [2.17] to [2.44].



provision. The EM also demonstrates the complexity of the task that applying the Bill is likely to require, and the contestability of the application of the relevant concepts.

The EM indicates that those applying the law (industry, the ACCC, the Treasurer and the Courts) must take into account “all facts and circumstances”. These extend from the broadest general industry trends to the specific circumstances of a particular retailer (eg its retail load, hedge position, whether it generates electricity and to what extent, particular contractual relationships, operating costs – even whether excessively frequent price changes might be detrimental to consumers). Given this breadth of factors, differing views about whether the provision may be breached in any particular situation are inevitable.

The examples in the EM serve to demonstrate the critical problems of interpretation and application brought about by the generality of the statutory language, but do nothing to assist their resolution.

The most uncertain parts of the retail pricing provision are shown in bold text above. AGL has particular concern with the following:

- **“Underlying cost of procuring electricity”:** Retailers’ underlying costs are highly complex and variable across the industry, and extremely difficult to ascertain with confidence, particularly for vertically-integrated retailers. Accordingly, the Bill proposes to use an unworkable standard as one of the key criteria for liability.

There is no certain or uncontroversial approach to calculating “underlying cost”, particularly for vertically-integrated retailers. Any approach will have inherent complexities in the calculation, whether be it focussed on the levelized costs of generation in the NEM, short run marginal costs of particular generators or regions in the NEM or long run costs, taking into account the need to recover very substantial capital investments in generation assets, or on a myriad of other possible formulations of “cost”. The EM further indicates that the relevant costs are subjective (i.e. specific to any particular retailer),<sup>19</sup> meaning that no objective or consistent standard or proxy can be applied.

As the EM acknowledges, every retailer will incur a different “cost stack”, and in particular a different wholesale cost. The wholesale energy costs incurred by a particular retailer are a combination of that retailer’s spot market exposure and hedging costs (including any physical hedging). Retailers’ wholesale energy costs differ materially based on their strategy for managing spot price exposure and risk appetite.

Vertically-integrated retailers face the additional difficulty of determining the relevant cost of physical hedging – which the EM acknowledges, adding that opportunity cost based on arm’s length transactions “may” be a relevant measure.<sup>20</sup> While there are a number of different methodological approaches to ascertaining an ‘opportunity cost’ based benchmark wholesale energy cost, AGL is firmly of the view that the opportunity cost approach must be the relevant measure in order to ensure a consistent approach across retailers capable of supporting a competitive market.

Further, the EM indicates that the use of the “underlying costs” concept means that a retailer’s compliance will not be determinable from externally observable factors. Rather, assessing compliance will require detailed examination of each retailer’s internal records (financial and accounting data). For example, the EM states:<sup>21</sup>

*Wholesale costs: Includes the retailer’s wholesale costs of: acquiring electricity from the spot market (or other form of market, where there is no relevant spot market); the costs of contracting to manage exposure to wholesale spot price volatility; or direct contracting within*

<sup>19</sup> See, e.g., EM, [2.31].

<sup>20</sup> EM, [2.28].

<sup>21</sup> EM, [2.26], [2.28] and [2.30].



*an entity in the case of a gentailer (vertically integrated businesses operating as both a generator and retailer);*

*...determining the costs of procuring electricity will involve a holistic analysis of the costs of each arm of the business;*

*...the analysis may include opportunity costs, rather than actual costs;*

*...cost may not always manifest itself as a direct cost... There may be cases where that cost is reflected in expenses that the retailer pays to intermediaries.*

As described in section 6.2 below, this makes intrusive and costly ACCC investigation of all retailers inevitable, whether they are in compliance or not.

To the extent further regulation of retail price is considered necessary (which is a matter already being considered by COAG and the AEMC), AGL submits that there should be a detailed and broad consultation on the appropriate methodology. Whatever approach is adopted following that consultation process, it should include a requirement that retailers give due consideration to the movement in the range of costs a retailer operating in a competitive market might incur, with reference to observable market prices.

- **Incorrect conflation of “costs” and “prices”.** The prohibition appears to assume a complete correlation between energy costs and prices to customers. However, a reduction in energy costs may be offset by changes to other components of the retail cost stack.<sup>22</sup>

The entire EM discussion appears to assume that retail prices are simply an aggregation of underlying costs: *“The components of retailer’s costs of procuring electricity (their ‘cost stack’), which make up the amounts retailers charge to their consumers...”*<sup>23</sup>

In a competitive market like electricity retailing, efficient retail prices are also influenced by competitive pressures, as well as input costs. The prohibition in section 153E risks being interpreted as being intended to replace the competitive process with regulation, and bases that regulation on only one component of the eventual retail price.

- **Wide variety of “offers” and “supplies”.** A retailer will make multiple offers at the retail level at different times, with varying terms. Those offers will subject to a number of variables including for example, the applicable State and transmission and distribution network, tariff types, daily and usage rates, discount structures and levels, etc. The EM acknowledges this complexity (describing the “wide range of retail products” as creating “substantial differences”), but does nothing to resolve the uncertainty it creates for determining what is required for compliance.<sup>24</sup> A retailer will have a similarly wide variety of supplies (ie existing retail contracts in place), which are likely to be subject to differing restrictions around whether, how and when the retailer may unilaterally vary those terms.
- **“Sustained and substantial reductions”.** The dual standard of “sustained” and “substantial” reductions creates significant uncertainty.

The provision stipulates that the time needed for a reduction in supply chain costs is to be “sustained”. According to the EM, *“a change that lasted a week or a month would be unlikely to be considered sustained”*, but there is no guidance beyond that.<sup>25</sup> Nor is there any particular statutory basis for the nomination of the periods listed in the EM, and regulators and other decision makers may subsequently depart from that guidance.

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<sup>22</sup> Other significant and variable retail electricity cost components include regulatory, network, retail and environmental costs.

<sup>23</sup> EM, [2.26].

<sup>24</sup> See, e.g., EM, [2.40].

<sup>25</sup> EM, [2.34].



The provision also stipulates that the quantum required for a reduction in costs must be “substantial”. According to the EM, this will be satisfied if the reduction is real or of substance relative to the overall cost, “*though not necessarily large*”.<sup>26</sup> Again, the use of such descriptors provides little practical certainty to market participants.

The EM indicates that when these two criteria are met, a retailer must consider whether, when and how to make a “reasonable” price adjustment. The uncertainty of these dual standards means that retailers will have significant difficulty determining whether the circumstances triggering a requirement to make a price adjustment have occurred. They will make compliance difficult, creating significant legal risk for retailers.

- **“Reasonable adjustments”.** The provision requires a retailer to make “reasonable adjustments” in certain circumstances. This concept is inherently subjective and uncertain. For example, the Bill provides no guidance on what level of price reduction is required for the adjustment to be “reasonable”, how and when the adjustment is to be made, what aspects of price in retail contracts must be adjusted, to which subset of customers, how an adjustment should be distributed as between different areas and as between “offers” and “supplies”.

In this context, the EM appears to confuse the concepts it seeks to apply, and is internally inconsistent – for example, it states that “*in undertaking an assessment of reasonable adjustments, the retailer’s overall operating costs will be relevant*”,<sup>27</sup> but elsewhere makes clear that the costs of procuring electricity do not include “*retail costs: the costs of running a retail business such as billing, marketing and consumer assistance costs*”.<sup>28</sup>

- The EM does not provide any specific indication of the time within which a retailer must adjust its prices in order to comply with the requirement in the proposed section 153E that it make a reasonable adjustment to its prices, other than to say it must be within a reasonable period.<sup>29</sup> AGL notes that retailer tariff decisions are typically planned for several months in advance of the annual adjustment cycles. Secondly, the National Energy Retail Law (**NERL**) prohibits price changes for small customers more regularly than once in a 6 month period, and requires compliance with notice provisions which require customers to be notified of such changes in advance.<sup>30</sup> Retailers may therefore face conflicting obligations making compliance impossible, given the prescribed process and permitted timing (typically annually and not more often than at 6 month intervals) for changes to standing offer rates under the NERL on which AGL’s consumer market offers are based.

Finally, AGL notes that this prohibition does nothing to address the concern identified in the Consultation Paper – “*consumers’ confusion about retail electricity offers*” and the difficulty of comparing retail offers.<sup>31</sup> Rather, the proposed prohibition risks an interpretation that is designed to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and so, in the long run, increase prices.

#### 4.4. Electricity financial contract liquidity prohibition

153F Prohibited conduct—electricity financial contract liquidity

A corporation contravenes this section if:

- (a) any of the following conditions are satisfied:
  - (i) the corporation generates electricity;

<sup>26</sup> EM, [2.35].

<sup>27</sup> EM, [2.41].

<sup>28</sup> EM, [2.27].

<sup>29</sup> EM, [2.36].

<sup>30</sup> The NERL, clause 8.2 provides that standing offer prices will not be varied more often than once every 6 months.]

<sup>31</sup> Consultation Paper, page 4.



- (ii) a body corporate that is related to the corporation generates electricity; and
- (b) the corporation does any of the following:
- (i) **fails to offer** electricity financial contracts;
- (ii) **limits or restricts its offers to enter into electricity financial contracts**;
- (iii) **offers to enter into electricity financial contracts in a way that has, or on terms that have, the effect or likely effect of preventing, limiting or restricting acceptance of those offers**; and
- (c) the corporation does so for the **purpose of substantially lessening competition** in any electricity market.

The most problematic parts of the electricity financial contract liquidity provision are shown in bold above. In particular, AGL is concerned by:

- **"Fails to offer".** The concept of "fails to offer" contracts is incapable of sensible application in the NEM. Derivative contracts are generally offered quarterly, and annually (both on the basis of financial year and calendar year) in advance of particular 5 minute or half hourly settlement periods in the physical spot market. Generators rarely contract in advance against 100% of their capacity or anticipated sent out energy, for a range of very good commercial reasons. There may be uncertainty about the availability of fuel, reliability of units may be uncertain, demand is uncertain. Different businesses will have different approaches to managing risk, taking into account shareholder's risk appetite, portfolio mix of assets (e.g. fuel type, running profile), and market conditions (e.g. transmission limitations). For vertically integrated generators they must also predict the likely demand of their own customers before determining their capacity to contract with third parties. All these matters are inherently uncertain, highly variable and managed through the application of judgement on a continuous basis. In addition, firms that trade in electricity derivatives conduct their trading around a 'net position' for each settlement period (being the net position of contracts bought and sold and managing any demand of a related retail business). Consequently, generators are in a continuous process of deciding whether or not to sell or buy contracts. The generality of the prohibition of "fails to offer" contracts in the context of the way in which generators manage their business in the ordinary course of business will mean that generators are not able to determine *ex ante* what conduct is lawful and what conduct is prohibited.
- **"Limits or restricts its offers".** The concept of "limits or restricts its offers" suffers from the same vice as "fails to offer".
- **Making offers in ways or on terms that prevent, limit or restrict acceptance of those offers.** Again, this concept is incapable of sensible application in the context of the normal trading of derivative contracts in the NEM. Contract trading in the market is conducted in an arm's length commercial context with both parties seeking to maximise their respective commercial advantage. The terms of those contracts include the type (for example, swaps, caps etc), the volume, the settlement periods and the commercial terms as to price, credit support etc. Every time a seller of contracts makes offers on terms that are not consistent with the terms sought by the potential buyer, the seller makes offers on terms that may prevent, limit or restrict acceptance, as the seller has no knowledge of whether the sought after terms are just a negotiating position or are in fact terms that if not satisfied will cause the buyer to not accept the offer. The generality of the standard of "terms that prevent, limit or restrict acceptance" of offers in the context of the way in which generators manage their business in the ordinary course of business will mean that generators are not able to determine *ex ante* what conduct is lawful and what conduct is prohibited.
- **"Purpose of substantially lessening competition".** Any rational participant in financial contract markets will need to limit or restrict its offers to enter into electricity financial contracts in the ordinary course of business – for example, to maintain counterparty credit worthiness standards. Accordingly, all vertically-integrated retailers and any significant generation business that has a relationship with a retailer will need to be able to demonstrate the "purpose" for which such decisions were made in order to avoid ordinary course and rational decisions from contravening section 153E.



The relevant prohibited purpose can be established by inference from any relevant circumstances, including from the conduct of any other person. The potential application of the prohibition must be considered in the context of the commercial and economic reality of the NEM. Current high prices are fundamentally caused by a lack of dispatchable generation, a tight supply-demand balance, and increasing fuel cost (coal and gas). The consequence of these conditions is that when generators decline to make offers or make them on terms the buyer does not find acceptable there is a real risk that there will be an effect on competition. In extreme circumstances failure to provide contract cover can be a step in a chain of events that causes small retailers to fail. The prohibition risks an interpretation which places on the generator the burden of establishing a negative proposition – that its purpose in declining to offer a contract or offering a contract on terms the buyer did not find acceptable – was not anti-competitive. This gives the ACCC significant discretion as to the matters and evidentiary standard that would be sufficient to establish the requisite “belief” of a corporation’s anti-competitive purpose – see part 6.2 below.

As discussed further below, placing on generators an unmanageable exposure to unfavourable spot market outcomes due to forced contracting is likely to result in increased costs of hedging products to account for this imposed risk.

## 4.5. Electricity spot market prohibition

153G Prohibited conduct—electricity spot market (basic case)

A corporation contravenes this section if:

- (a) the corporation:
  - (i) bids or offers to supply electricity in relation to an electricity spot market; or
  - (ii) fails to bid or offer to supply electricity in relation to an electricity spot market; and
- (b) the corporation does so:
  - (i) **fraudulently, dishonestly or in bad faith;** or
  - (ii) for the purpose of **distorting or manipulating prices in that electricity spot market.**

As with the proposed section 153F, the above provision will apply to conduct carried out in the ordinary course for generation businesses – both bidding and not bidding (“failing to bid”) – and will apply to all generation businesses, not just those that are able to exercise market power. Accordingly, all generators will need to be able to demonstrate the “purpose” for which such decisions were made in order to avoid ordinary course and rational decisions from contravening section 153G.

The “**aggravated case**” electricity spot market prohibition (section 153H) is drafted in substantially similar terms, with the additional requirement that both (b)(i) and (b)(ii) are satisfied. The “aggravated case” prohibition is therefore subject to the same uncertainties as the “basic case” prohibition (section 153G).

However, the relevant purpose provisions under (b) are uncertain. AGL is particularly concerned by:

- “**Fraudulently, dishonestly or in bad faith.**” First, although these concepts are linked in the statutory text, there is a material distinction between conduct that may be fraudulent or dishonest and conduct conducted in bad faith. Bad faith may include dishonesty or fraud, but does not **require** it, and “*is a wider notion, potentially applicable to diverse species of conduct*”.<sup>32</sup> It has been held to encompass conduct “*...falling short of the standards of acceptable commercial behaviour observed by reasonable and experienced persons in a particular area*”.<sup>33</sup> Previous judicial consideration of “bad faith” in the specific context of electricity markets demonstrates some of these complexities.<sup>34</sup> Severe penalties (such as

<sup>32</sup> Fry Consulting Pty Ltd v Sports Warehouse Inc (No 2) [2012] FCA 81 at [164] per Dodds-Streeton J.

<sup>33</sup> Fry Consulting Pty Ltd v Sports Warehouse Inc (No 2) [2012] FCA 81 at [165] per Dodds-Streeton J.

<sup>34</sup> Australian Energy Regulator v Stanwell Corporation Limited (2011) 197 FCR 429.



contracting orders and divestiture, which apply to breaches of section 153H) should not depend on the application of such a subjective and indeterminate test.

In addition to being inherently subjective and imprecise, the phrase “fraudulently, dishonestly or in bad faith” seeks to regulate similar conduct to that already regulated by existing NEL provisions that apply different standards and norms of conduct, including a prohibition on “false, misleading or likely to mislead” bidding (see further part 8.1 below).<sup>35</sup> As a result, the ACCC and the AER will have overlapping enforcement responsibilities, creating regulatory uncertainty and the potential for differing compliance standards.

- **“Distorting or manipulating prices”.** The phrase “distorting or manipulating” is similarly undefined and unclear, particularly given that every legitimate bid (or decision to not bid) has the potential to impact the relevant spot price. The NEM spot market is a regulatory construct that matches bids to demand on a 5 minute by 5 minute basis. Under the design of the NEM all generators receive the “marginal price” (being the price of the last bid necessary to be dispatched to meet demand). For this reason, no generator knows at the time of its bid whether it will be the “marginal generator”, so that it will not be possible for generators to know in advance whether their conduct is likely to contravene the proposed standard. The practical complexities of determining a line between legitimate participation in the energy only spot market and prohibited conduct are significant.

The basic design and function of the NEM, employing an auction-based clearing mechanism, results in effectively all bids (or withheld bids) impacting the spot price in the market. The proposed prohibition is likely to distort bidding incentives and undermine a fundamental premise of the NEM, being that the market price is set on the basis of the last bid necessary to meet demand.

Contrary to the assumptions underpinning the Bill, the prohibitions in sections 153G and 153H are likely to undermine the NEM’s function of providing appropriate and efficient signals for investment and the use of scarce inputs such as gas and water.

## 4.6. Potential Constitutional issues

Finally, AGL remains concerned that the Bill may raise a number of constitutional issues, so that if the Bill is enacted in its current form there would be a real risk that parts will be open to challenge.

- **The Bill may impermissibly confer judicial power on the Treasurer:** section 153W empowers the Treasurer to determine a contracting order that is “*a proportionate means of preventing the relevant corporation … from engaging in … prohibited conduct*” in future. That is, the Treasurer, rather than a Court, is given power to determine the relevant entity’s future rights and obligations as a consequence of identifying and establishing a past breach of the law. While the Bill provides that the order may only be enforced by a Court, in practical and substantive terms the Treasurer’s determination is conclusive, given the limited role afforded to the Court by the Bill once the ACCC and Treasurer have decided that prohibited conduct has occurred. Conferring a discretion to impose legal consequences including adjustment of private rights and obligations on the executive in this way arguably infringes the separation of judicial power provided for by Chapter III of the Constitution.
- **The Bill may impermissibly confer non-judicial power on the Federal Court:** under section 153Z(3), the Court is empowered to make orders requiring compliance with a contracting order made by the Treasurer pursuant to section 153W, but is precluded from determining for itself whether the corporation has actually engaged in the prohibited conduct which is a necessary precondition to the exercise of the Treasurer’s powers to make a contracting order. This effectively usurps the Court’s traditional functions under Chapter III of the Constitution and renders it into little more than a “rubber stamp” for the decisions

<sup>35</sup> For example, clauses 3.8.22 and 3.8.22A of the NEL create a prohibition on submitting offers, bids and rebids that are false, misleading or are likely to mislead.



made by the Treasurer regarding the existence and extent of prohibited conduct and the appropriate remedies for that conduct.

- **Divestiture orders:** similar concerns apply to the power vested in the Court to make a divestment order under the proposed section 153ZB. That provision requires the Court to determine whether "*the conduct identified in the [Treasurer's] recommendation*" is prohibited conduct within the meaning of the statute. It is at least possible that this provision has the effect of impermissibly depriving the Court of its exclusive function under Chapter III of being the primary finder of fact, and instead requires the Court to make an assessment of whether there has been prohibited conduct based solely on the description of the conduct identified and established by the Treasurer and "identified" in the Treasurer's recommendation, rather than independently determining what conduct actually occurred, and whether the actual conduct, as distinct from the conduct described in the recommendation, was in fact a breach of the law.

AGL considers that the Bill should be amended to properly reflect the judicial functions of the Court and to avoid constitutional uncertainty.



## 5. Conferral of power on AER to issue legislative instruments

*Under the colour of conferring “information gathering powers” on the AER, the Bill confers power on the AER to issue legislative instruments concerning the AER’s existing functions and powers, which are not subject to the usual forms of judicial or merits review and which are not amenable to scrutiny or disallowance by Parliament. This is an unusual and draconian approach to decision making and one which is more usually reserved for the arenas of Ministerial level decisions concerning national security or intelligence matters.*

*The introduction of the power prepares the ground for some form of retail price control, bypassing the current COAG process, but the power is not confined to this function.*

*AGL is highly concerned at the use of a measure of this kind and the possible ramifications.*

### 5.1. The AER’s new powers

Schedule 2 of the Bill is entitled “AER Information gathering”. However, it is apparent that the powers being conferred by Schedule 2 clearly extend well beyond information gathering.

AGL is particularly concerned with Clause 2 of Schedule 2 of the Bill. It confers power on the AER to make legislative instruments concerning the AER’s existing functions and powers, by amending section 44AH of the CCA. These amendments are likely to operate broadly in accordance with their terms, which are that:

- the Commonwealth may currently make regulations under the CCA giving the AER functions (current CCA, section 44AH(b));
- it is now proposed that those regulations may empower the AER to make legislative instruments (new CCA, section 44AH(2)); and
- legislative instruments made by the AER under those powers would not be subject to disallowance by Parliament under the *Legislation Act 2003* (Cth) (new CCA, section 44AH(3)).

Nothing in the Bill limits the new legislative function being conferred on the AER to being exercised only for the purpose of gathering information. Nor is the power expressly directed to monitoring compliance with the new prohibited conduct provisions in the Bill.

Rather, it seems the power to legislate is intended to permit the AER to regulate retail electricity prices, and to do so in a manner which is effectively beyond the oversight of the Federal Court, bypassing the current consideration by COAG of these issues. The EM notes that if a retail electricity code is developed, the code would include a retail price cap and that the amount of the cap would be determined by way of non-disallowable legislative instruments issued by the AER pursuant to the new power conferred by Schedule 2.<sup>36</sup> No further legislation would be needed for the AER to be given power (under regulation) to set retail price caps. The EM asserts that because such functions are “most suited to an independent economic regulator, the determination of these amounts in a non-disallowable instrument is appropriate”.<sup>37</sup> However, the power to set a retail price cap by means of a legislative instrument essentially confers a discretion on an arm of the executive to arrive at a decision based on particular facts. It ought not be done by means of legislative instrument:

*The general distinction between legislation and the execution of legislation is that legislation determines the content of a law as a rule of conduct or a declaration as to power, right or duty, whereas executive authority applies the law in particular cases.<sup>38</sup>*

<sup>36</sup> EM, [7.22].

<sup>37</sup> EM, [7.22].

<sup>38</sup> *The Commonwealth v Grunseit* (1943) 67 CLR 58 at 82 per Latham CJ.



The EM provides no justification or explanation of why this function is being sought to be put beyond not just Parliamentary oversight but also practically beyond any meaningful type of merits review, judicial review or appeal mechanism.

## 5.2. Limited scope for any kind of review

The power to issue legislative instruments is typically reserved for Ministerial decision making in statutory contexts associated with defence or national security, such as border control (including to designate a country as a regional processing country),<sup>39</sup> quarantine import decisions<sup>40</sup> and declaring that an organisation is a terrorist organisation.<sup>41</sup>

Unlike an administrative decision, a legislative instrument applies with the force of legislation and is not amenable to merits review or traditional judicial review, save on very limited grounds. The main ground on which a Court may review a decision made by way of legislative instrument is whether the making of the instrument is “... so lacking in reasonable proportionality as not to be a real exercise of the power” conferred upon the decision maker to make the legislative instrument.<sup>42</sup>

The more usual grounds of judicial review (such as failing to afford procedural fairness, failing to take into account relevant considerations, acting unreasonably or for an improper purpose, and taking into account extraneous or irrelevant considerations) either will not apply at all to delegated legislation, or will be applied at a much higher threshold compared to judicial review of executive action.<sup>43</sup>

This means that a decision made by the AER by way of legislative instrument pursuant to the power proposed to be conferred by the Bill will be (i) binding; (ii) not subject to disallowance by Parliament; and (iii) subject to very limited challenge or judicial review by a Court.

## 5.3. AGL’s concerns with the AER’s new powers

AGL considers that the introduction of the legislative instrument making power is potentially damaging, because:

- the power has been introduced without consultation, and completely ignores the current COAG and AEMC process<sup>44</sup> – indeed, the EM is clear that the Federal Government is proposing to give the AER the power to regulate retail prices. This is occurring without COAG support;<sup>45</sup>
- even if that is the intended use of the power, it is not limited in that way, and may be used in aid of any existing power or function of the AER, and any function conferred in future by regulation. The passage of such a broad ambulatory power is highly unusual and does not appear to have any policy rationale;
- there is no merits review and only very limited scope for judicial review of decisions made by legislative instrument; and
- the Bill provides that AER legislative instruments will not be subject to disallowance by the Parliament, save where the contrary is expressly provided for by regulation.<sup>46</sup>

<sup>39</sup> The *Migration Act 1958* (Cth) empowers the Minister: to designate a country as a regional processing country (section 198AB); declare a class of persons as an (excluded) fast track applicant (section 5 (1AA)).

<sup>40</sup> Sections 303EB and 303EC of *Environment Protection and Biodiversity Conservation Act 1999* (Cth).

<sup>41</sup> Section 102.1AA(2) of the *Criminal Code Act 1995* (Cth) provides that if satisfied on reasonable grounds the AFP Minister may, by legislative instrument, declare an organisation a “terrorist organisation”.

<sup>42</sup> *South Australia v Tanner* (1989) 166 CLR 161 at 168.

<sup>43</sup> *Attorney-General (SA) v Corporation of Adelaide* (2013) 249 CLR 1 at [49]-[54] per French CJ.

<sup>44</sup> See, AEMA, clause 6.8.

<sup>45</sup> EM at [7.22].

<sup>46</sup> The Bill, Schedule 2, clauses 2(3) and 2(4).



## 6. Remedies are disproportionate and so discretionary as to be arbitrary

*Enforcement frameworks should be transparent, proportionate and provide protections for procedural fairness. AGL has significant concerns with the enforcement framework for the prohibited conduct provisions especially given the uncertain nature of key parts of those provisions.*

*Further, the thresholds permitting the exercise of the new powers are low, as is the degree of evidentiary satisfaction a decision maker is required to meet in order to exercise their powers under the Bill. The result is to confer inherently discretionary and arbitrary powers on the ACCC and Treasurer, making the laws highly uncertain in their application.*

*The divestiture and contracting orders allow the Treasurer or Court to alter the behaviour of energy industry participants, or break those companies apart, altering the market structure. Such powers will have a significant impact on the industry, even if never used.*

*AGL considers that these remedies, particularly the divestiture and contracting orders, are disproportionate, punitive and contrary to the fundamental tenets of the rule of law. AGL also considers that the existing remedies under the CCA are sufficient to regulate and deter misconduct which further points to the disproportionality of the remedies.*

### 6.1. Remedies are disproportionate and arbitrary

It is a fundamental principle of the rule of law that remedies for breaches of the law ought to be proportionate, not penal, and not so discretionary in their application as to constitute effectively an arbitrary exercise of power.

In relation to the CCA misuse of market power prohibitions, the Final Report of the National Competition Policy Review delivered on 25 August 1993 (the **Hilmer Report**) stated:

*...misuse of market power sanctions must strike a balance between deterring undesirable unilateral conduct, encouraging business certainty and minimising the regulatory interference in daily business decisions.<sup>47</sup>*

AGL submits that the remedies provided for by the Bill (in particular, the contracting and forced divestiture orders) do not strike an appropriate balance between the type of conduct they seek to deter and the impact of the remedy on the affected business.

The prohibited conduct provisions, together with the threat of enforcement of one of the remedies, will fundamentally alter the businesses affected.<sup>48</sup> AGL considers that both the threat and impact of the remedies on the targeted businesses will likely negatively impact electricity prices and ultimately harm consumers. The potential impacts of these remedies are particularly concerning given there is no compelling basis for such an interventionist approach, which is incompatible with the economic and competition principles that underlie Australia's electricity markets and economy more generally.

<sup>47</sup> Hilmer Report, page 74.

<sup>48</sup> The Treasurer contracting orders and Court-ordered divestiture are not available as a remedy in respect of a contravention of the retail pricing prohibition (section 153E) or the basic case electricity spot market prohibition (section 153G). However, other remedies under the Bill, including issuing a public warning notice or infringement notice, instituting civil penalty proceedings or seeking an enforceable undertaking, are available to respond to a breach of these prohibitions.



## 6.2. The Bill provides the Treasurer and ACCC with highly discretionary and arbitrary powers

One consequence of the broad and vaguely drafted provisions is that the Treasurer and the ACCC are given highly discretionary powers as to when, how and against whom they will enforce these prohibitions, and what the resulting remedy will be.

The ACCC's powers and recommendations are exercised pursuant to a "reasonable belief" test. In particular, the ACCC can exercise the following powers based on "reasonable belief" alone:

- give a public warning notice to a corporation engaging in prohibited conduct (sections 153L and 153M);
- issue an infringement notice to a corporation engaging in prohibited conduct (section 153N);
- issue a prohibited conduct notice to a corporation engaging in prohibited conduct (section 153P); and
- make a prohibited conduct recommendation to the Treasurer that it should either make a contracting order, apply to the Federal Court of Australia for a divestiture order, or take no action (sections 153R and 153S).

This gives the ACCC significant discretion as to the matters and evidentiary standard that would be sufficient to establish the requisite "reasonable belief". AGL does not consider that applying a standard of "reasonable belief" as the threshold for the issue of a prohibited conduct notice (section 153P) is sufficient, given the potential consequences of such a notice, particularly in the absence of any provision for independent merits review of the ACCC's decision.

AGL is also concerned by the following matters:

- **The scope to impose substantial financial penalties:** AGL notes that ACCC public warning notices and infringement notices are, in practice, difficult to oppose or challenge, particularly where the threat of an even more onerous remedy remains. Section 153N increases the applicable penalty for an infringement notice by a factor of 10, to 600 penalty units (currently \$126,000). AGL is concerned that the penalties will not be ascribed to a particular course of conduct, and instead could be ascribed to individual incidents making up a course of conduct, in which case the quantum of the penalty would be multiplied significantly (depending on the number of incidents). These penalties would be imposed without a Court hearing or judicial determination. In this context, these penalties are disproportionate to the type of conduct which they seek to deter.
- **The choice of "proportionate" as the relevant legal standard for the ACCC and Treasurer to formulate a remedy is uncertain, and may be open to arbitrary exercises of power.<sup>49</sup>** It is not clear how it is intended that they will apply that standard.

The High Court has previously observed that there are "two radically different ideas" that are labelled with the language of "proportionality".<sup>50</sup> The first, associated with the criminal law, is that a sentence imposed as punishment must be "*proportionate in the sense that it properly reflects the personal circumstances of the particular offender and the particular conduct in which the offender engaged when those circumstances and that conduct are compared with other offenders and offending*".<sup>51</sup> The second, associated with constitutional law, is that a restriction upon a qualified constitutional freedom is

<sup>49</sup> See the Bill sections 153P(1)(b), 153S(1)(b), 153W(f). In the case of the divestiture orders, the Court must is also required to engage in proportionality analysis: 153ZA(f).

<sup>50</sup> *Magaming v The Queen* (2013) 252 CLR 381, [51] (French CJ, Hayne, Crennan, Kiefel and Bell JJ).

<sup>51</sup> *Magaming v The Queen* (2013) 252 CLR 381, [51] (French CJ, Hayne, Crennan, Kiefel and Bell JJ).



justified only if it is proportionate in the sense of being reasonably appropriate and adapted to achieve a legitimate end compatibly with the freedom.<sup>52</sup> More elaborate tests have also been articulated.<sup>53</sup>

Sections 153P, 153S and 153W require “proportionality” between the order and the object of preventing the relevant corporation from engaging in a particular kind of prohibited conduct, namely the kind of conduct that is has been found to have engaged in in the past. In this context, it is not clear which idea of “proportionality” is applicable. Given this uncertainty, businesses will be unable to determine which remedies are likely to flow from the circumstances.

- **ACCC influence over the energy market.** The Bill empowers the ACCC to recommend that the Treasurer make a contracting order, which may be implemented without any recourse to a Court. If the Bill becomes law the ACCC would be given a concerning degree of influence over the operation of the energy market and the investment environment in each jurisdiction. This is antithetical to the reform program undertaken by all Australian Governments since the Hilmer Report in 1993 to remove public sector control and influence over the operation of the energy market.<sup>54</sup>
- **The Bill makes detailed ACCC investigations inevitable even into compliant businesses.** The drafting of the Bill will make pervasive, intrusive and costly ACCC investigations inevitable, even for businesses that are in compliance with the prohibitions. For example, for the retail pricing prohibition, following any “broad, market-wide price trend” that the ACCC “reasonably believes” to be a sustained and substantial reduction in supply chain costs, the ACCC may (and likely will) consider it appropriate to engage in intrusive and costly evidence gathering across the whole industry, to confirm whether each retailer’s adjustment (if any) was “reasonable” in compliance with this provision.<sup>55</sup> This will be the case even where a retailer has not contravened the provision, and even when the retailers’ costs of procuring electricity bears little or no connection to the spot market price (due, for example, to its established long-term hedge position). This represents the imposition of a wholly unwarranted and very substantial new compliance burden on retailers, which will inevitably increase retail prices.

The Bill provides that the ACCC’s section 155 powers will be available if the ACCC has “*reason to believe that a person is capable of furnishing information, producing documents or giving evidence*” relevant to a Treasurer’s order.<sup>56</sup> In effect, the ACCC will be able to exercise its section 155 powers not only to investigate a possible contravention of a Treasurer’s order, but possibly also to monitor compliance. Whilst AGL recognises the importance of government agencies having sufficient powers to investigate, they should not be given effectively unrestricted powers to do so.

The conferral of such extreme and interventionist powers over retail pricing and investment in the Australian electricity industry on the regulator is both counter-productive and unprecedented, and is likely to create further uncertainty in the market, chilling investment incentives.

### 6.3. Treasurer contracting orders

The Bill gives the Treasurer power (once “satisfied” that a contravention has occurred) to make orders that directly interfere with electricity contracts between private businesses. The nature of these orders is that the Treasurer is empowered to set price caps and mandate particular supplies and types of electricity contracts.

The contracting orders are unnecessarily intrusive and risk substantially affecting private rights and agreements in the electricity market. Even the threat of a contracting order risks affecting the freedom with which private parties should be afforded (and indeed, should be protected) during the bargaining process.

<sup>52</sup> See, e.g., *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520.

<sup>53</sup> *McCloy v New South Wales* (2015) 257 CLR 178.

<sup>54</sup> Hilmer Report, pages 185-7, 215-237 (Chapter 10: Structural Reform of Public Monopolies), 293-308 (Chapter 12: Competitive Neutrality).

<sup>55</sup> EM, [2.32].

<sup>56</sup> The Bill, Part 2, Section 12. See CCA, sections 155(1) and (2).



This has the potential to negatively affect electricity prices and deter new market entrants – chilling both investment and competition in the market.

AGL is strongly of the view that the contracting orders do not strike an appropriate balance, when considering the prohibited conduct provisions (and their uncertainty) and potential impacts on affected businesses set out above.

AGL is particularly concerned with the following:

- **Such an order would likely reduce efficiency for vertically integrated retailers.** Requiring a vertically integrated retailer to supply a minimum volume of hedge contracts has the potential to materially reduce that business' ability to hedge efficiently and to operate and maintain its generation assets efficiently. Such an order would reduce the business' ability to cost-effectively manage pool price risk associated with its own retail customers. This is likely to result in increasing the costs of a vertically integrated retailer to serve its own customer base.
- **The contracting orders risks creating the perception of political influence over the competitive market.** This risk is exacerbated because section 153Z does not require the Court, when dealing with an application to enforce a contracting order made by the Treasurer, either to form an independent view whether the corporation has even engaged in prohibited conduct, or to amend the Treasurer's contracting order in any meaningful way.
- **The mooted Treasurer-issued “price cap” orders referred to in the EM, if introduced, would create similar issues to those raised by the contracting orders.<sup>57</sup>** Placing a limit on a business' pricing discretion for its products (retail electricity offers) will limit its ability to recover costs, price discriminate and potentially require it to sell those products at a loss (depending on its costs, hedge position etc).

## 6.4. Court-ordered divestiture

The Bill proposes that forced divestiture of assets be available as a remedy in respect of a contravention of the aggravated case electricity spot market prohibition (section 153H). AGL opposes the proposed divestiture remedy in the strongest possible terms, because:

- divestiture as a remedy is largely unknown in Australian legal regimes and unsupported by the ACCC;
- divestiture is an extreme remedy and likely to have both punitive and unintended consequences; and
- divestiture of assets is unlikely to address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity) (see further part 9 below).

AGL considers that empowering a Court to make a divestiture order is highly inappropriate. Providing a Court with the ability to exercise such an interventionist power risks distorting the proper functioning of the market, particularly given the Court's limited and judicial role and lack of procedural fairness afforded in the process set out in section 153S leading up to a divestiture order (the making of a prohibited conduct recommendation).

AGL has the following additional concerns with the divestiture remedy:

- **Divestiture is not a “last resort”, and was not recommended by the ACCC.** In its Final Report, the ACCC itself concluded that a divestiture remedy was not appropriate, and recommended against its introduction:<sup>58</sup>

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<sup>57</sup> See EM, [8.47].

<sup>58</sup> ACCC, Final Report, page 89.



*...the ACCC does not believe it would be appropriate to intervene to unwind the way in which the market has evolved across the NEM.*

Despite the ACCC's recommendation, the Consultation Paper included divestiture as a potential remedy for the prohibited conduct contemplated by the Draft Legislation, but stated that divestiture would only be applied "as a *last resort*". The Bill contains no such limitation and it is left to the Court's discretion.

ACCC Chairman Rod Sims has indicated that the threat of a divestiture remedy has the potential for overreach and to create uncertainty:

*...I think [a divestiture power] is a stick that would be called on to be used many more times than would ever make sense to use it.<sup>59</sup>*

*... I think divestiture powers are very tricky things because you can't narrow them to one market. If you have divestiture powers, people are going to ask you to use them left right and centre.<sup>60</sup>*

- **Previous independent reviews do not support divestiture as a remedy (outside the merger context).** Over recent years, several independent competition law reviews (namely, the Dawson, Hilmer and Harper Reviews) have considered whether "divestiture" is an appropriate remedy to address market power concerns. Outside of the merger and acquisitions context, divestiture has never been recommended as an appropriate remedy, on the basis that:
  - Courts would be involved in a process with inevitable political implications, something more appropriate for decision by governments,<sup>61</sup> given courts are generally not well positioned to make decisions about industry policy.<sup>62</sup>
  - Existing remedies are sufficient to deter a firm from misusing its market power and to protect and compensate parties harmed by unlawful conduct.
  - A general divestiture remedy would often be arbitrary since it would not be clear what parts of a firm should be divested.
  - An entire industry could be reshaped causing consequent disruption such as eliminating economies of scale and/or decreasing economic efficiency.
  - Although reducing the size of a firm may limit its ability to misuse its market power, divestiture is likely to have broader impacts on the firm's general efficiency or leave divested parts of a business unviable. Such changes could also have negative flow-on effects to consumer welfare.
  - The severity of the remedy is such that firms facing divestiture proceedings could be expected to strenuously oppose the proceedings resulting in costly and lengthy proceedings.<sup>63</sup>
  - Whilst divestiture is available in the US as a remedy for violations of the anti-monopolisation provision (as distinct from mergers), it is rarely used.<sup>64</sup> In that context, US Courts have referred to the logistical difficulty of unscrambling corporations that have expanded through organic growth without greatly harming the efficiency of a viable market participant.<sup>65</sup>
- **Divestiture is likely to be disproportionate, punitive in nature and will produce a number of unintended consequences.** Vertically integrated retailers have been the predominant investors in new supply for the last 10 years. Vertically integrated retailers are also the market participants most

<sup>59</sup> Radio National, 31 Oct 2018 – Fran Kelly interviews Rod Sims.

<sup>60</sup> Sky News, 12 Sept 2018 – Rod Sims interviewed by Trading Day.

<sup>61</sup> Hilmer Report, pages 163-5.

<sup>62</sup> Harper Review, page 346.

<sup>63</sup> Hilmer Report, pages 163-5.

<sup>64</sup> Harper Review, page 346.

<sup>65</sup> The Final Report of the Review of the Competition Provisions of the Trade Practices Act delivered in 2003 (the **Dawson Report**), page 162.



impacted by the threat of the exercise of a divestment power. Divestiture of retail assets may be against the interests of the consumers who have elected to enter into contracts with the targeted business. Divestiture of generation assets for a vertically integrated retailer at best increases its own costs of supplying its customers, and at worst presents the retailer with pool price risks that it cannot manage. Divestiture of listed companies' assets would be a significant and unjustified incursion into shareholders' interests.

Investors will also inevitably take the risk of forced divestiture into account, potentially raising the cost of capital for investments made by energy companies and adding a new source of risk for equity and debt financiers. The impact will be to reduce available capital in the market for energy investments, and potentially lead to an unwarranted destruction of shareholder value. The cost of debt finance may also rise as lenders to energy companies identify a substantial risk to asset values, placing upward pressure on the cost of funds for new investments.

Rather than addressing a demonstrated market failure, given the operational and economic reality of how the NEM functions, the divestiture power is likely to be punitive. It will not address concerns raised with the current operation of the electricity market. Instead, it is likely to increase risks and costs borne by market participants, due to rising costs of capital, all of which is likely to exacerbate, rather than ameliorate those issues.

- **Divestiture as a remedy will not address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity) and other market issues.** To the extent that the divestiture remedy is intended to address concerns with vertical integration, there is no economic justification for requiring vertically integrated retailers to divest assets, nor any basis for concluding that such a remedy would address the public concern about high energy prices. As described in AGL's 8 November Submission, economic analysis indicates that vertical integration does not reduce contract liquidity, increase the ability or incentive for gentailers to withhold of capacity in the wholesale market or cause increases in spot prices.<sup>66</sup> Divestiture in this context appears to be intended more as a penalty, rather than a remedy.

## 6.5. Remedies will deter investment

Large scale generation investments require a stable policy environment that is not subject to uncertainty and highly interventionist remedies in order to provide confidence of a return on investment. AGL believes that uncertainty in the market, especially around energy policy and regulation, have been and continue to be a primary disincentive to large scale generation investments. As the Independent Pricing and Regulatory Tribunal (NSW) observes:

*...the most effective way governments can ensure sustainable retail energy prices in the future is to provide a stable and predictable energy market framework. This stability will encourage new investment in the wholesale market, which is essential to increase supply and replace existing generation as it reaches the end of its asset life.<sup>67</sup>*

In that regard, AGL submits that the threat of contracting orders and forced divestment of assets, along with the lack of procedural fairness in the process leading to their enforcement (see further part 7 below), would have a chilling effect on necessary investment in the electricity sector. In particular, the remedies would significantly reduce investment incentives in new large scale, dispatchable generation capacity.

<sup>66</sup> AGL's 8 November Submission, pages 5-6, 11, 14.

<sup>67</sup> Independent Pricing and Regulatory Tribunal (NSW) (IPART), Review of the performance and competitiveness in the NSW retail energy market from 1 July 2017 to 30 June 2018, November 2018, page 2.



Key industry stakeholders and reviews have warned that the type of remedies contemplated by the Bill will deter investment. For example, the Australian Energy Council in its submission in response to the Consultation Paper on 8 November 2018 stated:<sup>68</sup>

*Policy certainty is critical for both the efficient operation of the current market and to encourage new participants to enter and compete with incumbents in order to drive down prices for consumers. Now is not the time for further heavy handed intervention in the electricity sector, and risks further destabilising the market at a time when policy certainty is needed to drive down prices and deliver positive customer outcomes.*

*... the actions touch on existing provisions in the Energy Laws, creating duplication. It is critical that electricity wholesalers and retailers can be certain of their obligations while operating in the market.*

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<sup>68</sup> Australian Energy Council submission in response to the Consultation Paper dated 8 November 2018, pages 1-2: <https://www.energycouncil.com.au/media/14523/20181108-aec-commonwealth-price-monitoring.pdf>



## 7. Lack of procedural fairness and inadequate scope for review

*The process and timeframes leading to the enforcement of a remedy under the Bill lack any semblance of adequate procedural fairness, given the magnitude of the potential consequences.*

*The failure to provide for meaningful merits review of decisions taken under the Bill is unacceptable.*

### 7.1. The process leading to the enforcement of the Bill's remedies lacks procedural fairness

The Bill permits orders to be made affecting the private rights, interests and dealings of a private corporation under contract, and without a hearing. Further, it exposes a private corporation to Court-ordered divestiture of its assets. This is almost certainly detrimental, given the lack of procedural fairness in the process leading up to such an order, and the uncertain statutory criteria upon which liability is conditioned.

AGL submits that the divestiture and contracting order process proposed by the Bill lacks protections for procedural fairness in at least the following respects:

- **Insufficient time to respond to an ACCC notice and no minimum time to respond to an ACCC recommendation or before the Treasurer makes an order.** The Bill provides just 45 days for a corporation to respond to an ACCC prohibited conduct notice.<sup>69</sup> At any time thereafter, the ACCC may issue a prohibited conduct recommendation to the Treasurer (and has 45 days to do so),<sup>70</sup> and the Treasurer may then make the recommended order at any time (and has 45 days to do so). Accordingly, a corporation has **just 45 days** to respond to the ACCC's "reasonable belief" of the contravention and its proposed remedies before an order may be imposed. A corporation is guaranteed **no opportunity or minimum time** to respond to the ACCC's prohibited conduct recommendation, nor to make representations to the Treasurer.
- **Corporations are not guaranteed notice of the conduct and information being considered by the Treasurer, nor the recommended remedies.** The Bill contains no provision requiring that a corporation receive a copy of the ACCC's prohibited conduct recommendation to the Treasurer. The corporation will have no certainty that it will be provided the information that is before the relevant decision-maker (the Treasurer) about the alleged conduct (apart from the information contained in a prohibited conduct notice)<sup>71</sup>, nor the remedies proposed (and by extension, the range of decisions that the Treasurer might make), nor the reasons and factual matters supporting each aspect of the ACCC's recommendation.

Further, section 153S(3) expressly contemplates the ACCC changing its proposed remedy/ies between providing a notice to the corporation and making a subsequent recommendation to the Treasurer. In those circumstances, there appears to be no requirement to notify the corporation of the proposed remedy/ies and no opportunity or minimum time to respond to the proposal to impose that remedy, nor the factual matters said to support it (see above).

- **No provision for the Treasurer to seek further information to support his or her final decision or requirement to give the affected corporation an opportunity to be heard.** AGL strongly considers that it is inappropriate for the ACCC, as the investigator, to have the power to make recommendations to the Treasurer which cannot be tested or adequately defended by the respondent company. There is no provision for merits review of any of these decisions as the Bill is currently drafted. This is an extraordinary position, given the nature of the prohibitions and the remedies available.

<sup>69</sup> See the Bill, section 153P. The ACCC may allow a later day (section 153P(3)(b)(ii)) or vary the notice (section 153Q), but there are no provisions dealing with extensions to this period nor the factors or standards relevant to any ACCC decision to allow a later day or vary a notice.

<sup>70</sup> The Bill, section 153Q.

<sup>71</sup> See the Bill, sections 153P, 153R, 153S(1)(a).



- **No transitional period – the prohibitions and penalties will apply immediately on royal assent, and to current conduct that continues to occur after that date.** This affords almost no time for AGL or other market participants to review the legislation as passed, obtain advice on its interpretation, effect and interaction with the NEL, NER, NERL and other applicable laws and regulations (which AGL anticipates will be subject to significant uncertainty), review their policies and procedures, and implement any changes. AGL also anticipates inconsistencies between the new prohibitions and other CCA prohibitions.

## 7.2. Review mechanisms

AGL is deeply concerned that the Bill proposes that there be no or only minimal oversight of the Treasurer's decisions (as well as the ACCC's decisions and recommendations):

- Decisions by the Treasurer (as well as the ACCC's decisions and recommendations) will **not be subject to disallowance by the Federal Parliament.**<sup>72</sup>
- The contracting orders can be imposed **without a Court finding that a corporation has contravened the new prohibitions**, for the reasons explained in part 4.6 above.
- **There is no provision for *merits review***, despite the Consultation Paper indicating that "*merits review and judicial review would be available for the Treasurer's determinations*".<sup>73</sup>

While a minimum level of judicial review of decisions will apply, the Treasurer's power to issue a contracting order only requires the Treasurer to be "satisfied" of various matters, including contravention of the new prohibitions. AGL submits that the magnitude of the intervention powers conferred on the Treasurer require that an assessment as to whether prohibited conduct has occurred must be correct and preferable, not just based on a "reasonable belief" of the regulator or the "satisfaction" of the Treasurer. Judicial review only assesses whether the power was validly exercised. It does not involve a review of whether the decision-maker made the correct and preferable decision on the substantive merits.

The limited nature of the review mechanisms available is deeply concerning given the uncertainty of the Bill and the highly discretionary powers proposed to be conferred by the Bill.

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<sup>72</sup> The Bill expressly provides that the ACCC's notices and recommendations are not legislative instruments and accordingly not subject to disallowance – see the Bill, sections 153L(3), 153M(4), 153P(6), 153Q(5), 153S(6), 153T(7), 153U(4), 153V(11).

<sup>73</sup> Consultation Paper, page 7.



## 8. Existing regulatory landscape

*AGL recognises the impact that sharp increases in energy prices are having on Australian consumers and businesses, as well as concerns about energy security and environmental sustainability. AGL understands and accepts that this raises legitimate concerns for Australian consumers. However, AGL does not believe that there are any deficiencies in the current legislative framework regulating the electricity sector that warrant the type of intervention contemplated by the Bill.*

*AGL is firmly of the view that given there is no “gap” in the existing regulatory regime, the proposed prohibitions are unnecessary, and will have unintended consequences contrary to the public interest. Further, no credible case for the introduction of these powers has been established. To support this view, AGL sets out its observations of the current regulatory landscape and its concerns with the prohibited conduct provisions below.*

### 8.1. No “gap” in existing laws and regulations

AGL would welcome regulation that would increase transparency and easy comparability of retail prices by consumers. However, the Bill does not contain any such measures.

The market is already highly regulated by the existing regime under the CCA (including the Australian Consumer Law (**ACL**)), the NEL and the NERL. AGL considers that the conduct sought to be addressed by the Bill is already comprehensively dealt with by the existing regime and that the new prohibitions are therefore unnecessary.

The fundamental premise of the new prohibitions is that the prohibited conduct causes market harm and takes unfair advantage of Australian consumers. The types of conduct the Bill is generally directed to are already effectively prohibited under the CCA, the NEL and the NERL. In particular:

- section 46 of the CCA prohibits the misuse of market power with the purpose of substantially lessening competition;
- section 45 of the CCA prohibits contracts, arrangements, understandings or concerted practices among competitors with the purpose of substantially lessening competition (without the requirement for market power);
- provisions in the ACL prohibit unconscionable conduct (section 21), misleading or deceptive conduct and representations about goods or services (sections 18 and 29) and unfair contracting (sections 23-28) which carry substantial and recently increased penalties; and
- provisions in the NEL already regulate the way in which generators make bids into the NEM spot market and false or misleading bidding of energy is already prohibited.

Compliance with the provisions of the CCA and the ACL are effectively enforced by the ACCC and the provisions of the NEL and the NERL are subject to supervision and enforcement by the AER.

Given this comprehensive coverage of harmful and disruptive anti-competitive conduct, the only additional scope of the new prohibitions is to capture conduct that does *not* harm the competitive process. Accordingly, the new prohibitions – which seek to capture conduct that harms the competitive process – are unnecessary.

Accordingly, an effective legal framework for ensuring competitive behaviour by electricity market participants is already in place. The sector is already heavily regulated, and further sector-specific regulation is unwarranted.



Whilst the panel of the Harper Review recognised that firms with a substantial degree of market power *may* engage in anti-competitive behaviour, many foreign jurisdictions have enacted prohibitions against unconscionable or unfair trading conduct between businesses.<sup>74</sup>

AGL notes that the scope of the misuse of market power prohibition (CCA, section 46) has recently been significantly broadened to cover conduct that has the effect of substantially lessening competition (the “effects test”). The scope and nature of the prohibition in section 46 was comprehensively considered by the Harper Review.<sup>75</sup> AGL understands that there would be a real risk that an “unreasonable refusal” by a major vertically integrated retailer to offer contracts to a rival would contravene section 46 of the CCA. As the Harper Review amendments to section 46 remain untested in the Federal Court, there is currently no basis to conclude that the law is deficient in some respect and unable to address concerns about misuse of market power in energy markets. Further, the Consultation Paper has not provided any clear economic or policy rationale for why conduct that would not otherwise be prohibited under section 46, should be captured under the proposed prohibitions.

Similarly, 2016 amendments to the NER to reform the “good faith” bidding rules on their face adequately address concerns regarding fraudulent, dishonest or bad faith wholesale bids.<sup>76</sup> AGL notes that those rules were the subject of careful consideration and consultation by the AEMC. It is noteworthy that notwithstanding the public interest in ensuring the bidding rules for the NEM are enforced, the AER has not yet commenced proceedings to enforce these rules since the 2016 amendments.

Further, a key concern of the ACCC Final Report was misleading marketing in relation to energy pricing. Confusion and the inability to compare offers contribute to consumers paying more than they should. AGL agrees that marketing practices need to be reformed and supports the introduction of a comparison benchmark, with COAG already agreeing on the need to develop a reference point/comparison rate against which all offers could be measured. Further, as discussed in its 8 November Submission, AGL is participating in the initiative to establish a voluntary comparison rate for retail electricity prices as announced by the Minister for Energy on 7 November 2018.<sup>77</sup>

Accordingly, there is no “gap” in the law that needs to be addressed by new prohibitions.

## 8.2. Insufficient basis for prohibitions

AGL considers that there is no sufficient basis for the prohibitions in light of the existing regulatory regime and the limited evidence available to justify their enactment. Whilst AGL recognises that there are legitimate concerns in the energy market, a number of inquiries and reviews are presently underway to address these concerns. Each of the prohibitions are considered in turn below to show why the prohibitions are unnecessary:

- **Retail pricing prohibitions.** AGL, other industry participants and regulators alike recognise that retail price deregulation has increased retail competition, has brought benefits to consumers (lower prices, more innovative products etc) and is preferable to a retail price control regime:

*Every year since electricity prices were deregulated in 2014, [the Independent Pricing and Regulatory Tribunal (NSW)] have assessed competition in the retail energy markets using key indicators. In 2017-18, like in all other years, [the Independent Pricing and Regulatory Tribunal*

<sup>74</sup> Harper Review, page 334.

<sup>75</sup> Harper Review, pages 60-63 and 335-348.

<sup>76</sup> See the *National Electricity Amendment (Bidding in Good Faith) Rule 2015 No. 13* and the Australian Energy Market Commission, *Potential Generator Market Power in the NEW Final Rule Determination*, 10 December 2015.

<sup>77</sup> <http://www.environment.gov.au/minister/taylor/media-releases/mr20181107.html>



(NSW)] found that each of these indicators either remained steady or improved compared to the previous year in NSW.<sup>78</sup>

Price re-regulation of currently deregulated jurisdictions is not clearly warranted and may result in far worse outcomes for consumers.<sup>79</sup>

Governments should continue to actively support customers in engaging in the market to place more pressure on retailers to offer competitive prices and services for the benefit of customers. On the other hand, re-regulating prices is likely to lead to higher prices in the longer term.<sup>80</sup>

The implementation and enforcement of a default price, as distinguished from the establishment of a market wide reference price, is the subject of intense political debate between the Commonwealth and the states. COAG has recognised that the re-introduction of price regulation in electricity markets may have unintended consequences and has referred the Commonwealth's proposed default tariff to the AEMC. The 20<sup>th</sup> Meeting Communiqué of the COAG states:<sup>81</sup>

*Ministers agreed on the need to develop a **reference point/comparison rate** against which all offers could be measured, for consideration at the December Council meeting. Western Australia, Victoria, Tasmania and the Northern Territory noted that this would not apply in their jurisdictions. Ministers also agreed that the AEMC undertake work on the impacts of the Commonwealth's proposed default tariff on competition issues and customer impacts including price for both standard and market customers in relevant jurisdictions.*

Similarly, the 21st Meeting Communiqué of COAG, which was held on 19 December 2018, also discussed the ACCC's Retail Electricity Pricing Inquiry and stated:<sup>82</sup>

*Ministers discussed the importance of bringing power prices down to provide relief to households and small businesses. Ministers agreed to the adoption of a reference bill by 1 July 2019, as proposed in the ACCC's Retail Electricity Pricing Inquiry, in network regions that do not have a regulated standing offer price. The Australian Energy Regulator (AER) will jointly determine the price with the affected jurisdictions. Ministers noted that Victoria is introducing its own regulated price to be in place by 1 July 2019 and therefore Victoria has asked the Commonwealth to direct the AER to cease work in that jurisdiction.*

*This would help consumers get on a better deal by having a **single reference bill** against which they can compare other offers. Ministers agreed to commence work on preparing any necessary changes to support the design and enforcement of the measure, including potentially enacting the reference bill through Commonwealth law to ensure its implementation by 1 July 2019.*

*Ministers noted the states' and territories' position that Commonwealth legislation should not be used to set reference prices or otherwise regulate electricity pricing without the agreement of the relevant jurisdiction.*

*Ministers noted the ACCC's proposal to implement the Consumer Data Right in the NEM in the first half of 2020; noted the AER's approach in current regulatory determinations to increase the uptake*

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<sup>78</sup> Independent Pricing and Regulatory Tribunal (NSW) (IPART), Review of the performance and competitiveness in the NSW retail energy market from 1 July 2017 to 30 June 2018, November 2018, page 2.

<sup>79</sup> AEMC, Final Report 2018 Retail Energy Competition Review, page 17.

<sup>80</sup> Independent Pricing and Regulatory Tribunal (NSW) (IPART), Review of the performance and competitiveness in the NSW retail energy market from 1 July 2017 to 30 June 2018, November 2018, page 1.

<sup>81</sup> COAG Energy Council 20th Meeting Communiqué Friday 26 October 2018:

<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/20th%20COAG%20Energy%20Council%20Communique.pdf>

<sup>82</sup> COAG Energy Council 20th Meeting Communiqué Friday Wednesday 19 December 2018:

<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/21st%20COAG%20Energy%20Council%20Communique.pdf>



*of cost reflective pricing; and agreed to changes to the AER's information gathering powers and reforms to civil penalty regimes.*

*Ministers also noted progress on other ACCC recommendations including actions to increase transparency of over-the-counter trades, speed up customer switching and streamline price reporting.*

AGL strongly supports the introduction of a **reference point/comparison rate** under the COAG process and establishing a voluntary comparison rate for retail electricity prices as announced by the Minister for Energy on 7 November 2018. At a minimum, consideration of default price regulation should be deferred pending the receipt of the advice of the AEMC. In particular, given the evolution of the NEM and that retail price deregulation has been the subject of careful and cooperative deliberations between the states and the Commonwealth since at least 1996. Any abrogation of these conventions shaping the development of energy policy is likely to have unintended consequences adverse to the public interest. AGL's view is that the COAG and AEMC processes are the appropriate forum for debating retail price regulation. In this context, it is not clear why the Commonwealth is proposing to introduce the Bill outside of these processes, especially if the Bill will:

- duplicate the COAG and AEMC processes on the introduction of a default tariff;
- amend or extend the manner in which any agreed default price will operate to influence retail pricing; or
- introduce a *de facto* form of price regulation administered by the ACCC.

- **Electricity financial contract liquidity prohibition.** AGL supports greater transparency in the hedging contract market. However, there is no evidence to support the need for this prohibition or the electricity spot market prohibition (see below). Where AGL has capacity in its portfolio to sell to third parties it does so and AGL is currently a provider of contracts to a number of smaller competitors.

In its Final Report, the ACCC set out no evidence that either vertical integration or levels of concentration in the market were in any way associated with high prices or reduced liquidity. AGL provided the ACCC with two economic studies that provided analysis to the contrary, which the ACCC did not substantively address. Frontier Economics (August 2017) concluded that:<sup>83</sup>

- Vertically integrated generators behave more competitively on average than when they were operating as stand-alone generators. Vertically integrated generators were found to be bidding 4% to 6% more capacity at competitive prices. That result is statistically significant.
- There is no statistical evidence that the trend towards vertical integration across the NEM has contributed to generators bidding at higher prices. Further, there is no compelling statistically significant evidence that horizontal integration has caused generators to bid more capacity at higher prices.

NERA Economic Consulting (November 2017) concluded that:<sup>84</sup>

- In electricity markets that lack the conditions required to foster liquid contract markets, vertical integration is an efficient competitive response to risk, which reduces the cost of risk management. Vertical integration therefore reduces costs throughout the market and puts downward pressure on prices to consumers. Increased vertical integration does not necessarily reduce liquidity in contract markets. The combination of circumstances that would prevent some generators and retailers from gaining access to hedging contracts is rare, and does not apply in Australia. Vertical integration by

<sup>83</sup> Frontier Economics, "Effects of vertical integration on capacity bidding behaviour" (August 2017), pages 2-3.

<sup>84</sup> NERA Economic Consulting, "International Experience of Vertical Integration in the Electricity Sector: A Report for AGL Energy Ltd" (22 November 2017), pages 2-3.



itself does not provide grounds for concern in this respect, because competing firms have an incentive to trade contracts even if they are vertically integrated.

Further, the remedy available in respect of a contravention of this prohibition – an order by the Treasurer to offer certain types of contracts – would have unintended and potentially punitive consequences, including limiting the ability of vertically integrated retailers to efficiently manage pool price with their own generation. The risk that a vertically integrated business may be effectively deprived of the “use” of its own generation as a risk management tool for its retail business will impose higher risks and therefore costs on that business.

AGL submits that the prohibition and remedy will not address the root causes of high pool prices and lack of hedge contract liquidity, which are structural and include the retiring of aging thermal generation, increasing gas and coal prices, and the limited ability of renewables to offer hedge contracts. In its Final Report, the ACCC identified the causes of increased wholesale prices as:<sup>85</sup>

- a shift in the mix of generators supplying electricity and setting wholesale prices;
- changes in the costs of generation, in particular increases in the costs of gas and black coal; and
- the current market structure.<sup>86</sup>

Additionally, the Energy Security Board (**ESB**) consulted on the ACCC's Final Report recommendations that would require (i) reporting of all over-the-counter (**OTC**) trades and (ii) large, vertically integrated retailers to offer hedge contracts each day in South Australia (market liquidity obligation or **MLO**). These recommendations are intended to increase contract market transparency and liquidity. AGL provided a submission in support of both recommendations. AGL supports cost-efficient initiatives to improve transparency and reduce information asymmetries provided that the compliance cost to industry are minimalised and confidential information is robustly protected. AGL positively supports market making mechanisms to improve market liquidity.

- **Electricity spot market prohibitions.** There is no evidence that the type of manipulation contemplated by this prohibition presents a significant problem to the operation of the market. Indeed, a number of reviews of wholesale bidding have been conducted in the last 12 months, none of which identified this type of conduct as common, or of significant concern.<sup>87</sup> It is noteworthy that the ACCC in its Final Report stated that “*clear instances of manipulation are not a major feature in the market today.*”<sup>88</sup>

The regulatory framework for the manner in which generators may bid their capacity into the spot market is well-developed and complex. That framework already prohibits misleading or deceptive bidding behaviour. Significantly, the AER has supervisory and enforcement powers in this area and has not taken any enforcement action against generators since 2011 (the year in which the Federal Court held that Stanwell Corporation Limited was not guilty of alleged breaches of the good faith bidding provisions under the NEL)<sup>89</sup> suggesting that fraudulent or abusive bidding practices are not a major concern in the NEM.

<sup>85</sup> ACCC, Final Report, page 54.

<sup>86</sup> The ACCC Final Report identified other factors contributing to increased *retail* prices more generally – including excessive increases in network costs, overly-generous solar feed-in tariff schemes, entry of low-emissions generation that cannot be dispatched to meet demand under the Renewable Energy Target, the exit of large coal-fired plants and increases in gas costs driven by LNG exports and government moratoria on onshore gas development.

<sup>87</sup> See, for example, ACCC, Final Report – see page 96 (Other than the “unique circumstances in Queensland” which lead the Queensland government to issue a directive to Stanwell concerning its bidding to put downward pressure on wholesale prices – see ACCC Final Report, pages 92-93); AER *Electricity wholesale performance monitoring – NSW electricity market advice* (December 2017) – see page 15; AER *Electricity wholesale performance monitoring – Hazelwood advice* (March 2018) – see page 17; and AEMC *Gaming in Rebidding Assessment (Grattan Response)* (September 2018) – see pages 35-36.

<sup>88</sup> ACCC, Final Report, page 96.

<sup>89</sup> Australian Energy Regulator v Stanwell Corporation Limited (2011) 197 FCR 429.



The proposed provisions in the Bill, which will introduce a new standard of “fraudulent, dishonest or bad faith” bidding for the “purpose of distorting or manipulating prices”, will be duplicative of the prohibitions that already exist in the NEL (including the “Good Faith” bidding provisions) and will result in the risk of double jeopardy as generators will face the risk of enforcement action by both the ACCC and the AER.<sup>90</sup> It also risks creating differing compliance standards.

The risk of unintended consequences is considerable, leading to inefficient market operation and negative flow on consequences for consumers and businesses. For this reason, the AEMC has an extensive process for considering and consulting on rule changes.<sup>91</sup>

In any event, the existing regulatory framework deals comprehensively with this type of conduct including:

- the NER concerning (re)bidding of generation capacity, including the recent and as yet untested “Bidding in Good Faith” rule (introduced 1 July 2016); and
- the CCA section 46 prohibition on the misuse of market power, including the recent and as yet untested “effects test” (introduced 6 November 2017).

Finally, key regulators and energy experts do not support this new prohibition. In a report commissioned by the ACCC as part of its Retail Electricity Price Inquiry, HoustonKemp cautioned against introducing a market power mitigation rule:<sup>92</sup>

*However, under the energy-only market design it is difficult to distinguish between those high price events that are legitimately providing signals for investment in new capacity from those that might represent an exercise of market power. The fundamental characteristics of this type of market mean that the impact of any market power mitigation measures on legitimate price signals need to be considered carefully.*

In its recent Gaming in Rebidding Final Report (September 2018), the AEMC found no evidence of material gaming in rebidding and concluded that “*the Commission does not consider the case for changing the rebidding arrangements has been made*”.<sup>93</sup> The AEMC concluded:<sup>94</sup>

*To the limited extent that bidding and rebidding behaviour in the market are seen to be a problem ... these issues related to industry structure should be addressed by policies that lower barriers to entry and promote efficient new investment ... Changes to the rules concerning bidding in the NEM are unlikely to resolve issues in the wholesale market that are driven by industry structure.*

AGL considers that, absent demonstrated and material deficiencies in the functioning of the generation bidding market or gap in the regulatory framework, further prohibitions targeted at electricity spot markets should not be legislated.

### **8.3. Inconsistency with existing energy policies and practices**

AGL considers that the Bill is inconsistent with a number of existing policies and practices in the current energy market. This will also create duplication, uncertainty and conflicts with the existing regime – all of which risk investment in the market. For example:

<sup>90</sup> For example, clauses 3.8.22 and 3.8.22A of the NEL create a prohibition on submitting offers, bids and rebids that are false, misleading or are likely to mislead.

<sup>91</sup> See <https://www.aemc.gov.au/our-work/changing-energy-rules>.

<sup>92</sup> HoustonKemp Economists, International review of market power mitigation measures in electricity markets – A report for the Australian Competition and Consumer Commissions (May 2018), page 5.

<sup>93</sup> AEMC, Gaming in Rebidding Final Report (September 2018), page (iii).

<sup>94</sup> AEMC, Gaming in Rebidding Final Report (September 2018), page 35.



- The retail pricing prohibition seeks to circumvent and abrogate the States' jurisdictional power over retail prices. The States are currently consulting on the introduction of a default retail price, and have requested that the AEMC advise them on the effect such regulation would have on competition. The Bill would render such consultation redundant, and will give the ACCC significant control and discretion over retail price setting. There will be material complexity in the interaction between the retail pricing prohibition and the prescribed process and permitted timing for changes to standing offer rates under the NERL.
- The electricity spot market prohibitions will distort bidding incentives and undermine a fundamental premise of the energy-only NEM, which is that temporary high spot prices allow generators to recover sunk costs and signal the need for investment. The prohibitions will also cover the same territory as provisions in the NER and result in the ACCC having powers which are duplicative of those already conferred on the AER.
- The AEMA unequivocally provides that the AER – not the ACCC – should be responsible for the energy-specific regulation of retail energy markets.<sup>95</sup>

Further, introducing electricity specific powers into the CCA instead of the NEL means that the Bill has not been tested for compliance with the National Electricity Objective.

## 8.4. Unintended consequences on the Australian energy market and economy

As the Bill is contrary to basic economic principles of energy markets in Australia, it will have unintended consequences that cause damage to the economy and are against the public interest. If the Bill is passed and comes into force, its likely effect will be to:

- Undermine the economic incentives towards productive, allocative and dynamic efficiency that the NEM seeks to establish. In that regard, AGL notes that section 153E makes no reference to competitive concepts such as "*effectively competitive market prices*", which would be necessary to preserve retail competition.
- Penalise more efficient businesses and significantly reduce vertically-integrated businesses' ability to recover the long-term costs of their generation investments, which will have an unprecedented impact on the proper functioning of the market.
- Subvert the premise of the market as an energy-only market and significantly reduce incentives to invest in new generation capacity or to remain vertically-integrated, which is an economically efficient market structure to reduce the risks inherent in Australia's electricity markets. The long-term result is likely to be higher costs of generation, and higher electricity prices to consumers.

These effects are potentially damaging given the prohibitions and penalties will apply immediately<sup>96</sup> – affording limited time for both market participants and the regulators to review the legislation as passed, obtain advice on its interpretation, effect and interaction with the NEL, NER, NERL and other applicable laws and regulation, review their policies and procedures, and implement the required changes.

<sup>95</sup> See AEMA, clauses 5.1(b) and 9.1(e).

<sup>96</sup> The Commencement provision of the Bill (Clause 2) provides that the new provisions will commence the day after the Bill receives the Royal Assent.



## 9. The Bill does not address key problems identified by the ACCC and others

*The Bill does not address key energy market problems identified in the ACCC's Final Report, including the imbalance of supply and demand in the wholesale market due to lack of investment, and consumer confusion in the retail market caused by a lack of transparency and comparability in retail prices.*

*The forced divestiture of assets proposed by the Bill is unlikely to address the underlying causes of higher energy prices (which include ongoing policy uncertainty, increasing input costs, and a shortage of dispatchable generation capacity).*

AGL is concerned that, in its current form, the Bill is deficient and does not address the factors actually driving high prices. Crucially, the Bill does not address the key problems facing the energy market identified in the ACCC's Final Report, including:

- **Imbalance of supply and demand due to lack of investment:**

*As prices in the wholesale and hedge markets increase, we would expect to see new investment in an energy-only market ... A lack of effective competition is a key risk to the market producing efficient price signals and to the market delivering low prices for consumers.<sup>97</sup>*

*[However] ...the current wholesale market structure is not conducive to vigorous competition. In an energy-only bidding market, it is particularly important that there is sufficient competition between generators to deliver efficient prices.<sup>98</sup>*

*The tightening of supply and demand, brought about mainly by the exit of large coal-fired generators, has seen a general 'lift' in wholesale prices across the NEM in recent years ... The ACCC has found that elevated prices have generally been driven by high and entrenched levels of concentration in the market, combined with fuel source cost factors, rather than identifiable uses or abuses of market power (for example, conduct of particular generators to 'spike' the price). The NEM was designed such that higher prices would ordinarily be a signal for new investment. Until recently, however, this investment has not occurred...<sup>99</sup>*

*Despite significant investment in renewables, new investment has not fully offset the reduction in supply from the closure of (predominantly low-cost) coal and gas plants over recent years.<sup>100</sup>*

- **Lack of transparency and comparability in retail prices causing consumer confusion:**

*...it is clear that many customers have difficulty engaging with the market. In many cases this arises from the complexity of the market and the difficulties that consumers face in being able to easily and accurately compare the value of different electricity offers.<sup>101</sup>*

*Retail electricity services should be relatively simple for consumers to understand and engage with.<sup>102</sup>*

*[However]... the retail market has developed in a manner that is not conducive to consumers being able to make efficient and effective decisions about the range of available retail offers in the market... the focus on discounts has become counter-productive, with consumers unable to*

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<sup>98</sup> ACCC, Final Report, page 88.

<sup>99</sup> ACCC, Final Report, page vii.

<sup>100</sup> ACCC, Final Report, page 53.

<sup>101</sup> ACCC, Final Report, page 149.

<sup>102</sup> ACCC, Final Report, page 234.



*effectively compare and rank offers or have a clear idea of what price they will be paying. This leads to both inflated costs (because retailers ‘compete’ in inefficient ways to attract and retain customers), poor outcomes for individual consumers and an inability for smaller retailers to put significant competitive pressure on larger retailers when confusion prevails in the market.<sup>103</sup>*

*Increasing the availability of relevant and personalised electricity consumption and pricing data to consumers and third parties will benefit consumers in many ways. It will facilitate development of new products and services, better inform decision making, enhance consumer and business outcomes (including on price) and facilitate greater efficiency and innovation in the economy.<sup>104</sup>*

AGL considers that the Bill (in its current form) is far removed from the concerns identified above by the ACCC and will do little or nothing to address those concerns. To the extent the Bill does purport to address the ACCC's recommendation regarding market manipulation, its operation has not been the subject of consultation. AGL considers that such heavy-handed and uncertain laws are likely to have unintended negative consequences. This further illustrates the deficiencies in the consultation process.

In particular:

- **The retail pricing prohibition does nothing to address the concern identified in the Final Paper – “consumers’ confusion about retail electricity offers” and the difficulty of comparing offers.**  
Rather, this prohibition seeks to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and in the long run, increase prices.
- **The market manipulation provisions are unjustified:** In a report commissioned by the ACCC as part of its Retail Electricity Price Inquiry, HoustonKemp cautioned against introducing a market power mitigation rule:<sup>105</sup>

*However, under the energy-only market design it is difficult to distinguish between those high price events that are legitimately providing signals for investment in new capacity from those that might represent an exercise of market power. The fundamental characteristics of this type of market mean that the impact of any market power mitigation measures on legitimate price signals need to be considered carefully.*

AGL acknowledges that the ACCC's Final Report recommended the introduction of a market manipulation rule, but the report contained no evidence in support of that recommendation. The Final Report conceded that “*clear instances of manipulation are not a major feature in the market today.*”<sup>106</sup>

Further, neither the ACCC's own consultants (HoustonKemp, quoted above) nor the AEMC recommended such a change. In its recent Gaming in Rebidding Final Report (September 2018), the AEMC found no evidence of material gaming in rebidding and concluded that “*the Commission does not consider the case for changing the rebidding arrangements has been made*”. The AEMC concluded:<sup>107</sup>

*“To the limited extent that bidding and rebidding behaviour in the market are seen to be a problem ... these issues related to industry structure should be addressed by policies that lower barriers to entry and promote efficient new investment ... Changes to the rules concerning bidding in the NEM are unlikely to resolve issues in the wholesale market that are driven by industry structure.”*

- **The prohibited conduct provisions for electricity financial contract liquidity and electricity spot markets and the contracting orders do not address the root causes of high pool prices and lack**

<sup>103</sup> ACCC, Final Report, page 134.

<sup>104</sup> ACCC, Final Report, page 254

<sup>105</sup> HoustonKemp Economists, International review of market power mitigation measures in electricity markets – A report for the Australian Competition and Consumer Commissions (May 2018), page 5.

<sup>106</sup> ACCC, Final Report, page 96.

<sup>107</sup> AEMC, Gaming in Rebidding Final Report (September 2018), page 35.



**of hedge contract liquidity.** In its Final Report, the ACCC identified the causes of increased wholesale prices as:<sup>108</sup>

- a shift in the mix of generators supplying electricity and setting wholesale prices;
- changes in the costs of generation, in particular increases in the costs of gas and black coal; and
- the current market structure.

The ACCC Final Report identified other factors contributing to increased *retail* prices more generally – including excessive increases in network costs, overly-generous solar feed-in tariff schemes, entry of low-emissions generation that cannot be dispatched to meet demand under the Renewable Energy Target, the exit of large coal-fired plants and increases in gas costs driven by LNG exports and government moratoria on onshore gas development. None of these will be addressed by the Bill.

- **The stated objective of financial liquidity prohibition indicates that it is based on the incorrect premise that contract liquidity issues are a result of vertical integration in the market.** The Consultation Paper stated that the objective of the contract liquidity prohibitions was to “*target conduct whereby a generator (likely a gentainer) unreasonably refuses to offer contracts to a rival at the retail level for anti-competitive purposes.*”<sup>109</sup>

Vertical integration provides a range of efficiencies to the NEM and there is no evidence that vertically integrated market participants restrict contracts or capacity to the market with the purpose of limiting competition.

Indeed, the analysis prepared by Frontier Economics and NERA Economic Consulting (and provided to the ACCC during its Retail Electricity Pricing Inquiry) found that liquidity has not suffered as a result of increased vertical integration. AGL considers that any lack of liquidity in hedge contracts is not the result of behaviour by vertically integrated participants, but rather is due to the current conditions of the broader wholesale electricity market – such as the tightening of supply and demand, the increase in semi-scheduled and non-scheduled plant that do not generally supply firm contracts and policy uncertainty discouraging investment. All generators, whether vertically integrated or not, have strong financial incentives to offer hedge contracts to retailers.

- **Divestiture of assets is unlikely to address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity).** AGL believes that uncertainty in the market, particularly around energy policy and regulation, have been and continue to be a primary disincentive to large scale generation investments. Large scale generation investments require a stable policy environment to provide confidence of a return on investment, not subject to uncertainty and highly interventionist remedies. Given that divestiture and the lack of procedural fairness in the enforcement process would have a chilling effect on necessary investment in large scale, dispatchable generation capacity, the proposed remedy of divestiture will not address the underlying causes of higher energy prices. Rather, it will only accentuate the causes.

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<sup>108</sup> ACCC, Final Report, page 54.

<sup>109</sup> Consultation Paper, page 5.



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## Electricity Legislation Consultation

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8 November 2018

### Consultation paper: Electricity price monitoring and response legislative framework

AGL Energy Limited (**AGL**) welcomes the opportunity to make a submission in response to Treasury's Consultation Paper titled *Electricity price monitoring and response legislative framework (October 2018)* (**Consultation Paper**).

AGL recognises the impact that sharp increases in energy prices are having on Australian consumers and businesses, as well as concerns about energy security and environmental sustainability. AGL understands and accepts the level of concern expressed in the Australian Competition and Consumer Commission's (**ACCC**) Retail Electricity Pricing Inquiry Final Report (June 2018) (**Final Report**) in respect of energy prices and the lack of transparency and comparability of energy offers faced by consumers. AGL agrees with many of the recommendations made by the ACCC in the Final Report, and endorses the need for reform of how energy products are marketed and sold, to move away from the current practices that do not give customers sufficient transparency and comparability.

AGL and other industry participants have been working with regulators to find a better way to make offers transparent and comparable. AGL will actively support initiatives designed to move the industry quickly towards enhanced transparency and comparability of energy offers, such as the initiative to establish a voluntary comparison rate for retail electricity prices, which was announced by the Minister for Energy following the roundtable with energy retailers on 7 November 2018.<sup>1</sup> AGL has also made unilateral steps to address some of these affordability concerns, and a list of these initiatives is attached at Annexure A.

Policy certainty is key to encouraging further generation supply investments, and this investment will place downward pressure on electricity prices. AGL notes in this context that vertically integrated retailers have been the predominant investors in new supply for the last 10 years. AGL has committed to five major power generation projects over the past year, totalling 1200MW of new capacity, which will put further downward pressure on prices.

However, the legislative framework that is proposed in the Consultation Paper presents a significant risk to investment in the energy market. The proposed framework outlines legislative provisions that are unnecessary, uncertain in their operation and impose extremely interventionist and disproportionate consequences, with vertically integrated retailers likely to be the most significantly impacted by the threat of divestment. AGL opposes the proposed legislative framework on the basis that:

- the new prohibitions are unnecessary, uncertain and will have unintended consequences that are against the public interest;
- the need for a 'default price' and the manner in which it would be used to regulate retailer pricing decisions is currently the subject of debate and consultation at both the Council of Australian Governments' (**CoAG**) and the AEMC. The provisions outlined in the Consultation Paper appear likely

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<sup>1</sup> Media Release, The Hon Angus Taylor MP – Minister for Energy, "Comparison rate to reduce confusion" (7 November 2018).



to either duplicate the introduction of a default tariff, amend or extend the manner in which a default price will operate or introduce a *de facto* form of price regulation administered by the ACCC. AGL's view is that the CoAG and AEMC processes are the appropriate forums for debating retail price regulation and the Commonwealth should not seek to duplicate these processes or alter any part of the agreed outcome through a separate legislative framework;

- the new remedies and responses are disproportionate, lack procedural fairness and will deter investment. In particular, AGL opposes the proposed divestiture remedy in the strongest possible terms. Providing the Treasurer with the ability to exercise such an interventionist power through an administrative process will distort the proper functioning of the market, particularly given the apparent lack of procedural fairness afforded in the process; and
- the case for the new remedies has not been effectively made. Recent comprehensive and rigorous reviews of the energy sector have not identified any need for remedies of this kind. In fact, credible parties such as the ACCC have noted that remedies of this nature are not justified.

Yours sincerely,

Beth Griggs  
**General Manager - Competition Regulation & Strategy**



## 1. Executive summary

AGL welcomes the opportunity to make a submission in response to Treasury's Consultation Paper. The Consultation Paper follows the Final Report.

The Consultation Paper outlines a framework for amending the *Competition and Consumer Act 2010* (Cth) (**CCA**) to introduce:

- three new prohibitions specific to the electricity sector that “broadly correspond” to the three main focusses of the ACCC’s Final Report: (i) retail prices; (ii) wholesale bids and conduct; and (iii) contract market liquidity; and
- new “remedies and responses” for contravention of those prohibitions, ranging from a public warning notice to ordering divestiture of an energy businesses’ assets (as a last resort).

**AGL considers that the new prohibitions are unnecessary, uncertain and will have unintended consequences that are against the public interest (see Section 2 below).**

- **Retail prices prohibition.** The need for a ‘default price’ and the manner in which it would be used to regulate retailer pricing decisions is currently the subject of debate and consultation at both the Council of Australian Governments’ (**CoAG**) and the AEMC. It is not clear how or why the Commonwealth is proposing to introduce provisions that will either (i) duplicate the CoAG and AEMC processes on the introduction of a default tariff, (ii) amend or extend the manner in which a default price will operate to influence retail pricing (**Option A**) or (iii) introduce a *de facto* form of price regulation administered by the ACCC (**Option B**). Neither option does anything to address the identified concern – “consumers’ confusion about retail electricity offers” and the difficulty of comparing offers. Rather, these options seek to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and in the long run, increase prices.

AGL strongly supports the introduction of a reference point/comparison rate, which the CoAG has agreed to consider in December 2018 and is participating in the initiative to establish a voluntary comparison rate for retail electricity prices, which was announced by the Minister for Energy following the roundtable with energy retailers on 7 November 2018.<sup>2</sup> CoAG has also referred the Commonwealth’s proposal for default price regulation to the AEMC for advice. At a minimum, consideration of default price regulation should be deferred until that advice is received. AGL’s view is that the CoAG and AEMC processes are the appropriate forum to debate issues relevant to retail price regulation.

- **Bidding and liquidity prohibitions.** The necessary premise of the liquidity proposal is that vertically integrated retailers are withholding contracts from their non-vertically integrated retail competitors. There is no evidence that this is the case, nor evidence to support the need for the proposed prohibitions concerning wholesale bidding. The proposed remedy to the liquidity prohibition – an order by the Treasurer to make contracts available – would have unintended and potentially punitive consequences, including limiting the ability of vertically integrated retailers to efficiently manage pool price with their own generation.

The prohibition and remedy will not address the root causes of high pool prices and lack of hedge contract liquidity, which are structural. There is no evidence that either vertical integration or levels of concentration in the market were in any way associated with high prices or reduced liquidity; indeed, economic advisors, Frontier Economics and NERA Economic Consulting, have drawn the opposite conclusion.

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<sup>2</sup> Media Release, The Hon Angus Taylor MP – Minister for Energy, “Comparison rate to reduce confusion” (7 November 2018).



- **No “gap” in existing laws and regulations.** The existing provisions of the CCA (including the Australian Consumer Law (**ACL**)) provide an effective legal framework for regulating the behaviour of market participants. The scope of the misuse of market power prohibition (CCA section 46) has recently been expanded to cover conduct causing anti-competitive “effects”, which remains untested. “Good faith” bidding rules introduced into the National Electricity Rules in 2016 on their face adequately address concerns regarding fraudulent, dishonest or bad faith wholesale bids, and the AER has not commenced enforcement proceedings under these amended rules yet.

**AGL considers that the new remedies and responses are disproportionate, lack procedural fairness and will deter investment (see Section 3 below).**

- **The enforcement process for the Treasurer-ordered “remedies”<sup>3</sup> lacks procedural fairness.** This is particularly the case given the serious consequences of the proposed remedies. In making its recommendation to the Treasurer, the ACCC is only required to “identify misconduct” and does not need to set out the material facts or evidence that they rely upon nor meet the evidentiary standard that would be required by a court. The respondent company has an extremely short (30 day) period to respond to the ACCC, and appears to have no opportunity to make submissions to the Treasurer or respond to the ACCC’s recommendation to the Treasurer. Merits and judicial review of the Treasurer’s determination may be available, but is likely to be limited in scope and application.
- **Divestiture is an extreme remedy, unsupported by the ACCC and likely to have unintended consequences - AGL opposes the proposed divestiture remedy in the strongest possible terms.** Divestiture is an extreme remedy that is largely unknown in Australian legal regimes. Divestiture of assets is unlikely to address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity).

Vertically integrated retailers have been the predominant investors in new supply for the last 10 years. Vertically integrated retailers are also the market participants most impacted by the threat the exercise of a divestment power that has no foundation in a court determining a contravention of the law. Divestiture of retail assets may be against the interests of the consumers who have elected to enter into contracts with the targeted business. Divestiture of generation assets for a vertically integrated retailer at best increases its own costs of supplying its customers, and at worst presents the retailer with pool price risks that it cannot manage. Divestiture of listed companies’ assets would be against the interests of shareholders.

Investors will also inevitably take the risk of forced divestiture into account, potentially raising the cost of capital for investments made by energy companies and adding a new source of risk for equity and debt financiers. The impact will be to reduce available capital in the market for energy investments, and potentially lead to an unwarranted destruction of shareholder value. The cost of debt finance may also rise as lenders to energy companies identify a substantial risk to asset values, placing upward pressure on the cost of funds for new investments.

Rather than addressing a demonstrated market failure, given the operational and economic reality of how the NEM functions, the divestiture power is likely to be punitive. It will not address concerns raised with the current operation of the electricity market. Instead, it is likely to increase risks and costs borne by market participants, due to rising costs of capital, all of which is likely to exacerbate, rather than ameliorate those issues.

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<sup>3</sup> Note, it is not conceded that any of the proposed Treasurer-ordered remedies are properly characterised as remedies, and are not more properly characterised as penalties. The word “remedy” is adopted in this submission for the purpose of consistency with the terminology used in Consultation Paper.



## 2. New prohibitions are unnecessary and uncertain

AGL does not believe that there are any deficiencies in the current legislative framework regulating the electricity sector that warrant the intervention contemplated in the Consultation Paper. AGL is firmly of the view that the proposed prohibitions are unnecessary, uncertain and will have unintended consequences that are against the public interest and that no credible case for these powers has been made out.

- **Retail prices prohibition.** The implementation and enforcement of a default price, as distinguished from the establishment of a market wide reference price, is the subject of intense political debate between the Commonwealth and the states. The issue has been referred to the AEMC for consideration.<sup>4</sup> In this context, it is not clear how or why the Commonwealth is proposing to introduce provisions that will either (i) duplicate the CoAG and AEMC processes on the introduction of a default tariff, (ii) amend or extend the manner in which a default price will operate to influence retail pricing (**Option A**) or (iii) introduce a *de facto* form of price regulation administered by the ACCC (**Option B**).

Neither option does anything to address the identified concern – “consumers’ confusion about retail electricity offers” and the difficulty of comparing offers. Rather, these options seek to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and in the long run, increase prices.

- **Bidding and liquidity prohibitions.** The necessary premise of the liquidity proposal is that vertically integrated retailers are withholding contracts from their non-vertically integrated retail competitors. Where AGL has capacity in its portfolio to sell to third parties it does so and AGL is currently a provider of contracts to a number of smaller competitors. There is no evidence to support the need for the proposed prohibitions concerning wholesale bidding and contract liquidity.

In its Final Report, the ACCC set out no evidence that either vertical integration or levels of concentration in the market were in any way associated with high prices or reduced liquidity. AGL provided the ACCC with two economic studies that provided analysis to the contrary, which the ACCC did not substantively address. Frontier Economics (August 2017) concluded that:<sup>5</sup>

- Vertically integrated generators behave more competitively on average than when they were operating as stand-alone generators. Vertically integrated generators were found to be bidding 4% to 6% more capacity at competitive prices. That result is statistically significant.
- There is no statistical evidence that the trend towards vertical integration across the NEM has contributed to generators bidding at higher prices. Further, there is no compelling statistically significant evidence that horizontal integration has caused generators to bid more capacity at higher prices.

NERA Economic Consulting (November 2017) concluded that:<sup>6</sup>

- In electricity markets that lack the conditions required to foster liquid contract markets, vertical integration is an efficient competitive response to risk, which reduces the cost of risk management. Vertical integration therefore reduces costs throughout the market and puts downward pressure on prices to consumers.
- Increased vertical integration does not necessarily reduce liquidity in contract markets. The combination of circumstances that would prevent some generators and retailers from gaining access to hedging contracts is rare, and does not apply in Australia. Vertical integration by itself

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<sup>4</sup> CoAG Energy Council, 20th Meeting Communiqué (26 October 2018).

<sup>5</sup> Frontier Economics, “*Effects of vertical integration on capacity bidding behaviour*” (August 2017), pages 2-3.

<sup>6</sup> NERA Economic Consulting, “*International Experience of Vertical Integration in the Electricity Sector: A Report for AGL Energy Ltd*” (22 November 2017), pages 2-3.



does not provide grounds for concern in this respect, because competing firms have an incentive to trade contracts even if they are vertically integrated.

The remedy to the proposed liquidity prohibition – an order by the Treasurer to make contracts available – would have unintended and potentially punitive consequences (see Section 3.2). Vertically integrated retailers manage their wholesale portfolio firstly to manage the risk of pool price exposure for their retail load. The risk that a vertically integrated business may be effectively deprived of the “use” of its own generation as a risk management tool for its retail business will impose higher risks and therefore costs on that business.

The prohibition and remedy will not address the root causes of high pool prices and lack of hedge contract liquidity, which are structural and include the retiring of aging thermal generation, increasing gas and coal prices, and the limited ability of renewables to offer hedge contracts. In its Final Report, the ACCC identified the causes of increased wholesale prices as:<sup>7</sup>

- a shift in the mix of generators supplying electricity and setting wholesale prices;
- changes in the costs of generation, in particular increases in the costs of gas and black coal; and
- the current market structure.

(The ACCC Final Report identified other factors contributing to increased *retail* prices more generally – including excessive increases in network costs, overly-generous solar feed-in tariff schemes, entry of low-emissions generation that cannot be dispatched to meet demand under the Renewable Energy Target, the exit of large coal-fired plants and increases in gas costs driven by LNG exports and government moratoria on onshore gas development).<sup>8</sup>

Further, the Energy Security Board (**ESB**) consulted on the ACCC’s Final Report recommendations that would require (i) reporting of all over-the-counter (**OTC**) trades and (ii) large, vertically integrated retailers to offer hedge contracts each day in South Australia (market liquidity obligation or **MLO**). These recommendations are intended to increase contract market transparency and liquidity. AGL provided a submission in support of both recommendations. AGL supports cost-efficient initiatives to improve transparency and reduce information asymmetries provided that the compliance cost to industry are minimalised and confidential information is robustly protected. AGL positively supports market making mechanisms to improve market liquidity.

- **No “gap” in existing laws and regulations.** The Consultation Paper contains, in support of the proposed obligations and remedies, hypothetical examples of the events and circumstances which the paper indicates would breach the proposed obligations and give rise to the need for the proposed remedies. In every case the existing provisions of the CCA (including the ACL) provide an effective legal framework for regulating the behaviour of market participants.

AGL notes that the scope of the misuse of market power prohibition (CCA section 46) has recently been significantly broadened to cover conduct that has the effect of substantially lessening competition (the “effects test”). The scope and nature of the prohibition in section 46 was comprehensively considered by the Competition Policy Review led by Professor Ian Harper (**Harper Review**). AGL understands that there would be a real risk that an “unreasonable refusal” by a major vertically integrated retailer to offer contracts to a rival would contravene the CCA section 46. As the Harper Review amendments to section 46 remain untested in the Federal Court, there is currently no basis to conclude that the law is deficient in some respect and unable to address concerns about misuse of market power in energy markets. Further, the Consultation Paper has not provided any clear economic or policy rationale for why conduct

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<sup>7</sup> ACCC, Final Report, page 54.

<sup>8</sup> ACCC, Final Report, page iv - v.



that would not otherwise be prohibited under section 46, should be captured under the proposed prohibitions.

Similarly, 2016 amendments to the National Electricity Rules to reform the “good faith” bidding rules on their face adequately address concerns regarding fraudulent, dishonest or bad faith wholesale bids. AGL notes that those rules were the subject of careful consideration and consultation by the AEMC. It is noteworthy that notwithstanding the public interest in ensuring the bidding rules for the National Electricity Market are enforced, the AER has not yet commenced proceedings to enforce these rules since the 2016 amendments.

Further, a key concern of the ACCC Final Report was misleading marketing in relation to energy pricing. Confusion and the inability to compare offers contribute to consumers paying more than they should. AGL agrees that marketing practices need to be reformed and supports the introduction of a comparison benchmark, with CoAG already agreeing on the need to develop a reference point/comparison rate against which all offers could be measured. Further, as discussed above, AGL is participating in the initiative to establish a voluntary comparison rate for retail electricity prices as announced by the Minister for Energy on 7 November.

Accordingly, there is no “gap” in the law that needs to be addressed by new prohibitions.

- **Potential for unintended consequences.** Finally, AGL urges caution and restraint in potentially amending the legal framework for the regulation of economic activity in the energy sector. The process of reform of major economic laws by the Commonwealth and CoAG has historically been undertaken in a careful and deliberative manner. For example, the Harper Review was subject to extensive and lengthy consultation and AGL considers a similar consultative process should be adopted for the proposed framework to ensure any reform is fit for purpose. This is precisely because economic laws can have profound and unintended consequences causing damage to the economy and to the public interest.

AGL sets out its comments on the draft prohibitions below. AGL notes that it is difficult to comment fully on the draft prohibitions, given that the Consultation Paper does not clearly articulate the problems that these prohibitions seek to address, nor how the prohibitions will operate.

## 2.1. Retail prices prohibition

The purported aim of the proposed retail price prohibition is to “*target retailer conduct which takes unfair advantage of consumers’ confusion around retail electricity offers and their difficulty in identifying and switching to better deals.*” Yet Options A and B do nothing to reduce any consumer “confusion”, nor to improve consumers’ ability to compare retail electricity offers. Rather, both options seek to regulate business activities through heavy-handed and uncertain regulation of energy business’ pricing decisions, potentially deterring competitive conduct. Both options suggest a form of retail price regulation.

Retail price deregulation has increased retail competition, bringing benefits to consumers (lower prices, more innovative products etc). *De facto* price re-regulation under Option A is highly likely to reduce competition, and diminish the benefits to consumers that competition brings. The implementation and enforcement of a default price, as distinguished from the establishment of a market wide reference price, is the subject of intense political debate between the Commonwealth and the states through CoAG. CoAG has recognised that the re-introduction of price regulation in electricity markets may have unintended consequences and has referred the Commonwealth’s proposed default tariff to the AEMC. The CoAG Communiqué states:<sup>9</sup>

*Ministers agreed on the need to develop a reference point/comparison rate against which all offers could be measured, for consideration at the December Council meeting. Western Australia, Victoria,*

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<sup>9</sup> CoAG Energy Council, 20th Meeting Communiqué (26 October 2018).



*Tasmania and the Northern Territory noted that this would not apply in their jurisdictions. Ministers also agreed that the AEMC undertake work on the impacts of the Commonwealth's proposed default tariff on competition issues and customer impacts including price for both standard and market customers in relevant jurisdictions.*

AGL strongly supports the introduction of a reference point/comparison rate under the CoAG process and establishing a voluntary comparison rate for retail electricity prices as announced by the Minister for Energy on 7 November. At a minimum, consideration of default price regulation should be deferred pending the receipt of the advice of the AEMC. AGL's view is that the CoAG and AEMC processes are the appropriate forum for debating retail price regulation. In this context, it is not clear why the Commonwealth is proposing to introduce Option A or Option B outside of these processes, which could either duplicate the debate and work being undertaken through these processes, could amend or extend the manner in which any agreed default price will operate to influence retail pricing, or introduce a form of *de facto* price regulation under the administration of the ACCC.

The evolution of the NEM and retail price deregulation has been the subject of careful and cooperative deliberations between the States and the Commonwealth since at least 1996 and any abrogation of these conventions shaping the development of energy policy is likely to have unintended consequences adverse to the public interest

To the extent that there is concern that some businesses may take “unfair advantage” of their customers, AGL notes that the ACL prohibits unconscionable conduct (section 21), misleading or deceptive conduct and representations about goods or services (section 18 and section 29) and unfair contracting (sections 23-28) which carry substantial and recently increased penalties. Any further prohibition should not duplicate the ACL regime.

## **Option A**

Option A proposes the following new prohibition:

*An electricity retailer must not charge its small customers a price that is higher than the default market offer unless this is justified by a substantial difference in the terms and conditions of the offer.*

The purpose and likely application of Option A is uncertain, for example, what is the “default market offer”, who makes it and how is it calculated? For the purposes of responding to the Consultation Paper, AGL assumes that the “default market offer” price is determined by a regulator on the basis of some estimate of “efficient” costs. Under Option A, even where a company has legitimate or reasonable reasons to price above the default market offer, the associated legal uncertainty of the prohibition and consequent risks of “remedies and responses” (see section 3 below) would potentially deter them from doing so. Accordingly, Option A has the potential to have the effect of capping retail prices at the “default market offer”.

AGL does not understand the basis for Option A given the current deliberation in respect of default pricing at CoAG. Option A appears likely to either duplicate any legislative or regulatory instrument following CoAG’s decision in this respect, or it will amend or extend the application of the default price as determined by CoAG.

## **Option B**

Option B proposes the following new “prohibition”:

*An electricity retailer must adjust the prices charged to its small customers to reflect sustained decreases in wholesale market costs.*

AGL notes that it is unclear what Option B proposes, given that it is not expressed as a prohibition.



Option B appears to seek to mandate that retailers pass-through reductions in wholesale market cost to consumers in circumstances where an agreed default price has not been implemented (a “default market offer” is expressly mentioned in Option A, but is not referenced in Option B). AGL suggests that in circumstances where the introduction of regulated pricing has not been agreed by CoAG, the introduction of this provision would need to be carefully considered. This will be particularly true if CoAG agree to a reference point/comparison rate, which will allow consumers to meaningfully compare different offers.

AGL considers that competition, not a legal prohibition, is the appropriate mechanism to drive the pass-through of any cost reduction to consumers. In this context, electricity retail markets are already effectively competitive. Legal restrictions that mandate “competitive” conduct are unlikely to improve competitive outcomes, and indeed are more likely to distort incentives and deter competitive conduct and efficient investment. This is particularly the case given that any implementation of Option B would require clarity and certainty in relation to a number of complex economic and legal concepts. For example:

- How will wholesale market costs be measured? Will the relevant costs be specific to each retailer (actual costs) or the market overall (some form of market estimate)? How will the “cost” of a physical generation hedge be measured? How will differences between NEM regions be taken into account?

Every retailer will incur a different wholesale cost. The wholesale energy costs incurred by a particular retailer is a combination of that retailer’s spot market exposure and hedging costs (including any physical hedging). Retailers’ wholesale energy costs differ materially based on their strategy for managing spot price exposure and risk appetite.

- What constitutes a “significant” decrease in wholesale market costs,<sup>10</sup> and over what period must it be “sustained”?

The NEM spot price varies on a half hourly basis between -\$1,000/MWh and \$14,500/MWh, but a retailer’s costs are determined by its hedge position which will be established months or years in advance.

- If a sustained decrease in wholesale market costs occurs, what price adjustment is required to avoid a contravention?

Option B appears to assume a correlation between “wholesale energy costs” and consumer prices. However, other significant and variable retail electricity cost components include regulatory, network, retail and environmental costs. A reduction in wholesale energy costs may be offset by changes to other components of the retail cost stack.

AGL further anticipates material complexity in the interaction between Option B and the prescribed process and permitted timing for changes to standing offer rates under the National Electricity Retail Law (**NERL**).

## 2.2. Wholesale bids and conduct

The Consultation Paper proposes the following prohibition:

*An electricity generator must not, when making a bid or offer to dispatch electricity, act fraudulently, dishonestly or in bad faith with the purpose of distorting or manipulating prices.*

AGL considers that such a prohibition is unnecessary. There is no evidence that this type of manipulation presents a significant problem to the operation of the market. The following reviews of wholesale bidding have been conducted in the last 12 months, none of which identified this type of conduct as common, or of significant concern:

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<sup>10</sup> The hypothetical example refers to a “significant” reduction, although the text of Option B does not.



- ACCC *Retail Electricity Pricing Inquiry – Final Report* (June 2018) – see page 96;<sup>11</sup>
- AER *Electricity wholesale performance monitoring – NSW electricity market advice* (December 2017) – see page 15;
- AER *Electricity wholesale performance monitoring – Hazelwood advice* (March 2018) – see page 17; and
- AEMC *Gaming in Rebidding Assessment (Grattan Response)* (September 2018) – see pages 35-36.

Further, the current regulatory framework deals comprehensively with this type of conduct, including under:

- the National Electricity Rules concerning (re)bidding of generation capacity, including the recent and as yet untested “Bidding in Good Faith” rule (introduced 1 July 2016);<sup>12</sup> and
- the CCA section 46 prohibition on the misuse of market power, including the recent and as yet untested “effects test” (introduced 6 November 2017).

AGL considers that, absent demonstrated and material deficiencies in the functioning of the generation bidding market or gap in the regulatory framework, further prohibitions should not be legislated.

The regulatory framework for the generation bidding market is well-developed and highly complex. The risk of unintended consequences is considerable, leading to inefficient market operation and negative flow on consequences for consumers and businesses. For this reason, the AEMC has an extensive process for considering and consulting on rule changes.<sup>13</sup>

Further, key regulators and energy experts **do not support** this new prohibition.

In a report commissioned by the ACCC as part of its Retail Electricity Price Inquiry, HoustonKemp cautioned against such actions:

*However, under the energy-only market design it is difficult to distinguish between those high price events that are legitimately providing signals for investment in new capacity from those that might represent an exercise of market power. The fundamental characteristics of this type of market mean that the impact of any market power mitigation measures on legitimate price signals need to be considered carefully.*<sup>14</sup>

In its Final Report, the ACCC decided **not** to recommend the introduction of a market power mitigation rule, finding that discrete instances of market power being used to spike the price were not a key cause of higher wholesale prices.<sup>15</sup> The Final Report stated that “*clear instances of manipulation are not a major feature in the market today.*”<sup>16</sup> The ACCC was also concerned that many of the market power mitigation rule options identified were likely to be a disincentive to new investment in generation by existing market participants.<sup>17</sup>

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<sup>11</sup> Other than the “unique circumstances in Queensland” which lead the Queensland government to issue a directive to Stanwell concerning its bidding to put downward pressure on wholesale prices – see ACCC Final Report, pages 92-93.

<sup>12</sup> <https://www.aemc.gov.au/rule-changes/bidding-in-good-faith>

<sup>13</sup> See <https://www.aemc.gov.au/our-work/changing-energy-rules>

<sup>14</sup> HoustonKemp Economists, International review of market power mitigation measures in electricity markets – A report for the Australian Competition and Consumer Commissions (May 2018), page 5.

<sup>15</sup> ACCC, Final Report, page 96.

<sup>16</sup> Ibid., page 96. While the ACCC suggested “*that such a rule is likely to be of increasing importance given the stronger links between the wholesale and contract markets envisioned under the draft design of the NEG [National Energy Guarantee]*”, the Government is no longer pursuing that policy.

<sup>17</sup> ACCC, Final Report, page 96.



In its recent Gaming in Rebidding Final Report (September 2018), the AEMC found no evidence of material gaming in rebidding and concluded that “*the Commission does not consider the case for changing the rebidding arrangements has been made*”.<sup>18</sup> The AEMC concluded:

*To the limited extent that bidding and rebidding behaviour in the market are seen to be a problem ... these issues related to industry structure should be addressed by policies that lower barriers to entry and promote efficient new investment ... Changes to the rules concerning bidding in the NEM are unlikely to resolve issues in the wholesale market that are driven by industry structure.*<sup>19</sup>

## 2.3. Contract liquidity

The Consultation Paper proposes the following prohibition:

*An electricity generator must not withhold, limit or restrict the availability of electricity financial contracts with the purpose of substantially lessening competition in an electricity market.*

AGL supports greater transparency in the hedging contract market, however, the proposed prohibition does nothing to address this policy issue and is unnecessary.

The stated objective of the proposed prohibition<sup>20</sup> indicates that it is based on the incorrect premise that contract liquidity issues are a result of vertical integration in the market. Vertical integration provides a range of efficiencies to the NEM and there is no evidence that vertically integrated market participants restrict contracts or capacity to the market with the purpose of limiting competition.

Indeed, as described above, the analysis prepared by Frontier Economics and NERA Economic Consulting (and provided to the ACCC during its Retail Electricity Pricing Inquiry) found that liquidity has not suffered as a result of increased vertical integration. Indeed, concerning AGL’s acquisition of Macquarie Generation specifically, Frontier Economics found that “*the transaction has resulted in an increase in liquidity ... Removing AGL from the demand side of the hedge market has increased the ease with which competing retailers can acquire hedge contracts*”.<sup>21</sup>

Any lack of liquidity in hedge contracts is not the result of behaviour by vertically integrated participants but rather the current conditions of the broader wholesale electricity market – such as the tightening of supply and demand, the increase in semi-scheduled and non-scheduled plant that do not generally supply firm contracts and policy uncertainty discouraging investment. All generators, whether vertically integrated or not, have strong financial incentives to offer hedge contracts to retailers.

The proposed remedy for this prohibition of the forced sale of financial contracts presents a very significant risk to generators operating in the market, and is likely to deter new entry and expansion (see Section 3.2).

As noted above, AGL understands that there would be a real risk that an “unreasonable refusal” by a major vertically integrated retailer to offer contracts to a rival for a proscribed purpose would contravene CCA section 46. Further, as noted above, the ESB consulted on the ACCC’s Final Report recommendations intended to increase contract market transparency and liquidity. AGL provided a submission in support of both recommendations as discussed above.

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<sup>18</sup> AEMC, Gaming in Rebidding Final Report (September 2018), page (iii).

<sup>19</sup> AEMC, Gaming in Rebidding Final Report (September 2018), page 35.

<sup>20</sup> The Consultation Paper states that the objective is “*to target conduct whereby a generator (likely a gentainer) unreasonably refuses to offer contracts to a rival at the retail level for anti-competitive purposes*”.

<sup>21</sup> Frontier Economics, Contract market liquidity in the NEM (May 2018), page 13.



### 3. Proposed Treasurer-ordered remedies inappropriate and lack procedural fairness

#### 3.1. Proposed enforcement framework for Treasurer-ordered remedies lacks procedural fairness

Enforcement frameworks should be transparent, proportionate and provide protections for procedural fairness. AGL has significant concerns with the proposed enforcement framework for the Treasurer-ordered remedies (see Section 3.2).

The framework allows the ACCC to form a view about whether an electricity company has engaged in prohibited conduct and then engage in “a notice and response process with the corporation” which could result in a range of punitive remedies imposed by the Treasurer. The Treasurer is to make his or her determination based on a recommendation from the ACCC supported by an ACCC report.

AGL has significant concerns about the lack of protections for procedural fairness for the process leading to the ACCC’s recommendation and Treasurer’s determination, particularly given the serious consequences of the proposed remedies. In particular:

- The ACCC is only required to “identify misconduct”. The ACCC is not required to set out the material facts and contentions upon which it relies or to disclose the “evidence” it has had regard to. No evidentiary standard is applied and consequently the ACCC could “identify misconduct” based on speculative, erroneous or misconceived assertion or analysis.
- The respondent company has minimal opportunity to understand the case against it and to respond to the ACCC.
  - The proposed framework does not require the ACCC to provide any document similar to a court pleading when notifying the corporation about the alleged conduct. This deprives the respondent company of the ability to fully understand the case against it and adequately respond to the allegations or rectify the conduct.
  - The proposed timeline of 30 days to respond to an ACCC notice is extremely short and disproportionate to the proposed remedies.
- The respondent company appears to have no opportunity to make submissions to the Treasurer directly or to respond to the report presented to the Treasurer by the ACCC. AGL strongly considers that it is inappropriate for the ACCC, as the investigator, to have the power to make recommendations to the Treasurer which cannot be tested or adequately defended by the respondent company.
- There appears to be a minimal oversight for the Treasurer’s determination process. The Consultation Paper notes that merits and judicial review would be available for the Treasurer’s determinations. These protections, particularly that of merits review, are essential. However, AGL would be greatly concerned should the review process be limited in scope and application. In order for the process to be in any way tenable, the ACCC report would need to be subject to merits review.

#### 3.2. Treasurer-ordered remedies inappropriate, disproportionate and will deter investment

AGL opposes each of the Treasurer-ordered remedies, which are inappropriate, disproportionate and will deter investment in the electricity sector.

**AGL opposes the proposed divestiture remedy in the strongest possible terms.** AGL’s firm view is that this remedy is neither necessary nor justified. Further, given the lack of procedural fairness protections for



this remedy its existence is likely to be distortionary on the proper function of the market and business decision making.

- **Remedies are highly interventionist and disproportionate.** Each of the three Treasurer-ordered remedies will fundamentally alter the businesses affected. Placing a limit on a business' pricing discretion for its products (retail electricity offers) will limit its ability to recover costs, price discriminate and potentially require it to sell those products at a loss (depending on its costs, hedge position etc). Requiring a gentainer to supply a minimum volume of hedge contracts has the potential to materially reduce that business' ability to hedge efficiently and to operate and maintain its generation assets efficiently. This remedy is likely to increase the costs of a vertically integrated retailer in serving its own customer base, as it reduces the business' ability to cost-effectively manage pool price risk associated with its own retail customers. Forced divestitures will break an efficient business apart, which is likely to result in less efficient remaining businesses.

Accordingly, the use of these remedies is likely to negatively impact electricity prices and harm consumers. The impact on the targeted business is likely to be disproportionate and punitive in nature.

As the ACCC stated in its Final Report concerning a divestiture remedy (which it did not recommend):

*"Requiring the divestiture of privately owned assets is an extreme measure to take in any market, including the electricity market."<sup>22</sup>*

ACCC Chairman Rod Sims has since publicly explained that he does not support a divestiture power:

*"I've long thought divestiture is a very big stick, very much last resort, and having that power on a continuing basis I think is tricky."<sup>23</sup>*

*"... my personal view is that divestment is probably not the best way to deal with energy prices..."<sup>24</sup>*

*"Divestiture is such an extreme step that we felt that judgement would be very hard to reach"<sup>25</sup>*

Mr Sims gave similar evidence before Senate Estimates:<sup>26</sup>

**Senator KETTER:** ... Did you provide a recommendation to the government for divestment powers in the energy sector?

**Mr Sims:** No, that wasn't one of our recommendations. I guess we took the view that there should be a range of forward-looking measures to promote competition...

There is no basis for such interventionist remedies, which are incompatible with the economic and competition principles that underlie Australia's electricity markets and economy more generally. If the new prohibitions were to be introduced, the Consultation Paper offers no justification as to why the existing and established classes of remedies under the CCA (notices and Court-ordered penalties) are insufficient.

- **Remedies will deter investment.** Given the significant uncertainty of these prohibitions, the lack of procedural fairness and the disproportionate and punitive nature of these remedies, their existence will significantly reduce investment incentives in the electricity sector – particularly investment in new large scale generation capacity.

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<sup>22</sup> ACCC, Final Report, page 89.

<sup>23</sup> Sky News, 12 Sept 2018 – Rod Sims interviewed by Trading Day.

<sup>24</sup> Radio National, 31 Oct 2018 – Fran Kelly interviews Rod Sims.

<sup>25</sup> Sydney Morning Herald, 25 Oct 2018 – Competition chief learnt of controversial energy plan when he 'read about it in the newspaper'.

<sup>26</sup> Senate Estimates Hearing, Economics Legislation Committee, 25 Oct 2018, – Rod Sims Evidence.



Divestiture of assets is unlikely to address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity). AGL believes that uncertainty in the market, particularly around energy policy and regulation, have been and continue to be a primary disincentive to large scale generation investments. Large scale generation investments require a stable policy environment to provide confidence of a return on investment, not subject to uncertainty and highly interventionist remedies.

Vertically integrated retailers have been the predominant investors in new supply for the last 10 years, 60%. AGL has committed to five major power generation projects over the past year, totalling 1,200MW of new capacity, which will put further downward pressure on prices. These include the:

- 100MW capacity upgrade at the Bayswater Power Station in NSW;
- 252MW Newcastle Gas Power Station at Tomago NSW;
- 200MW Barker Inlet Power Station in SA;
- 464MW Coopers Gap Wind Farm in QLD; and
- 200MW Silverton Wind Farm in NSW.

In total, this is a \$2 billion capital investment. AGL is contributing \$900 million from its balance sheet and 20% of shared equity as part of the Powering Australian Renewables Fund for the remaining \$1.1 billion.

The proposed divestiture remedy and the lack of procedural fairness in the enforcement process would have a chilling effect on necessary investment in large scale, dispatchable generation capacity.

ACCC Chairman Rod Sims has alluded to this potential for the threat of divestiture to create unnecessary uncertainty:

*“...I think [a divestiture power] is a stick that would be called on to be used many more times than would ever make sense to use it.”<sup>27</sup>*

*“... I think divestiture powers are very tricky things because you can't narrow them to one market. If you have divestiture powers, people are going to ask you to use them left right and centre.”<sup>28</sup>*

- **Divestiture remedy will not address market issues.** To the extent that the divestiture remedy is intended to address concerns with vertical integration, there is no economic justification for requiring vertically integrated retailers to divest assets, nor any basis for concluding that such a remedy would address the public concern about high energy prices. As described above, the economic analysis indicates that vertical integration does not reduce contract liquidity, increase the ability or incentive for gentailers to withhold of capacity in the wholesale market or cause increases in spot prices. There is no nexus between divesture of assets and the conduct such a direction purports to address. Divesture in this context is a penalty rather than a remedy.

In its Final Report, the ACCC itself concluded that a divestiture remedy was not appropriate, and did not recommend its introduction:

*“...the ACCC does not believe it would be appropriate to intervene to unwind the way in which the market has evolved across the NEM.”<sup>29</sup>*

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<sup>27</sup> Radio National, 31 Oct 2018 – Fran Kelly interviews Rod Sims.

<sup>28</sup> Sky News, 12 Sept 2018 – Rod Sims interviewed by Trading Day.

<sup>29</sup> ACCC, Final Report, page 89.



Similarly, the Harper Review widely consulted on the introduction of a divestiture remedy but concluded that the existing range of remedies under the CCA were sufficient to deter a company from misusing its market power.<sup>30</sup>

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<sup>30</sup> Competition Policy Review, Final Report, March 2015, page 345.



## Annexure A

AGL has been working to improve affordability by:

- Cutting electricity prices in New South Wales, Queensland and South Australia.
- Investing in new generation capacity, as discussed above, AGL and our partners are currently developing 1,200 megawatts of new generation capacity, representing investment of more than \$2 billion.
- The Energy Insights<sup>31</sup> service to help customers understand energy usage by appliance category.
- Introducing AGL Essentials,<sup>32</sup> which is a fixed low-rate offer presented as a dollar amount per day that is easy to understand.
- Introducing AGL Prepaid<sup>33</sup> to give customers more control over when and how much they pay.
- The Here to Help service<sup>34</sup> to help customers connect with tailored financial assistance options.
- The Fairer Way program<sup>35</sup> to support low-income and vulnerable households. AGL also has a Staying Connected program to support customers in financial hardship.<sup>36</sup>
- As part of AGL's FY18 Full-Year Results announcement,<sup>37</sup> AGL announced initiatives for vulnerable and standing offer customers including:
  - A new \$50 million relief program for Staying Connected customers, including cancelling debts aged more than 12 months and offering dollar matching on other debt repayments.
  - Extending the standing offer loyalty plan to customers in all states (South Australia, Victoria, New South Wales and Queensland) providing automatic loyalty discounts to electricity customers on standing offers who have been with AGL for at least two years.
  - Launching a guaranteed annual plan review for all standing offer customers.
  - Launching a new Small Business Assist energy advice, efficiency and financial counselling program.

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<sup>31</sup> <https://www.agl.com.au/help/managing-my-account/energy-insights>

<sup>32</sup> <https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2018/january/agl-simplifies-energy-with-low-and-fixed-rate-digital-only-energy-plan>

<sup>33</sup> <https://campaign.agl.com.au/landing/residential/prepaid-tl/?webid=PrepaidAQValue1>

<sup>34</sup> <https://www.agl.com.au/heretohelp>

<sup>35</sup> <https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2017/march/agl-announces-a-fairer-way-package-for-vulnerable-customers>

<sup>36</sup> <https://www.agl.com.au/help/payments-billing/staying-connected-hardship-program>

<sup>37</sup> <https://www.agl.com.au/about-agl/investors/results-centre>; <https://www.agl.com.au/-/media/aglmedia/documents/about-agl/asx-and-media-releases/2018/180809fy18resultspresentation1829086.pdf>



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## Electricity price monitoring and response regime draft legislation

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22 November 2018

### AGL response to electricity price monitoring and response regime draft legislation

This submission contains AGL Energy Limited's (**AGL**) response to the exposure draft of the "*Treasury Laws Amendment (Electricity Price Monitoring) Bill 2018*" (**Draft Legislation**) provided to AGL on 16 November 2018.

AGL recognises the impact that sharp increases in energy prices are having on Australian consumers and businesses, as well as concerns about energy security and environmental sustainability. AGL understands and accepts the level of concern expressed in the Australian Competition and Consumer Commission's (**ACCC**) Retail Electricity Pricing Inquiry Final Report (June 2018) (**Final Report**) in respect of energy prices and the lack of transparency and comparability of energy offers faced by consumers.

However, AGL does not believe that the Draft Legislation provides an effective means of addressing those concerns, nor the root causes of increases in energy prices. The Draft Legislation risks establishing a framework of obligations that are so broad and ambiguous that energy companies will not be able to ascribe a sensible meaning to them. This will cause significant interruption to the normal commercial operation of energy businesses.

Indeed, **even if these new powers are never used**, the uncertainty created by the Draft Legislation will exacerbate the problem, by deterring efficient competitive conduct and creating significant additional investment risk, further chilling already low incentives to invest in much needed new generation capacity.

In summary, AGL submits that:

- **There are fundamental, overarching concerns with the Draft Legislation, including in respect of its practical application. AGL is of the view it will be impossible for energy companies to know how to comply.** The key operative provisions of the Draft Legislation are so broad and uncertain that it will be impossible for retailers and generators to operate with any confidence that they are complying with the law. The Draft Legislation appears contrary to the economic principles on which energy markets in Australia are designed to operate and gives the ACCC excessively interventionist and highly discretionary powers. For these reasons, the Draft Legislation will have unintended consequences that are against the public interest, including chilling investment in new generation capacity, increasing prices and may also reduce system reliability.

The Treasurer's divestiture orders are disproportionate and punitive, and even the potential for their application will increase the risks of investing in generation capacity. While the Consultation Paper referred to divestiture being applied only "*as a last resort*", the Draft Legislation contains no such limitation.

Given that the prohibitions will have immediate effect (with no transitional period) and the extreme remedies and penalties available, the Draft Legislation will cause significant disruption to electricity companies' businesses and to energy markets. The legislation is so broad and uncertain that it will effectively transfer the policy power to the ACCC, which will be left to determine the meaning of the provisions, without the discipline provided by merits review. Simply put, the rule-making and



enforcement effectively rests with the same entity. AGL submits that legal norms should reflect the will of the Parliament, and be capable of interpretation by the corporations subject to those norms.

- **Draft Legislation lacks procedural fairness and is contrary to the rule of law.** As currently drafted, the Draft Legislation permits the Treasurer to make an order that a private corporation divest its assets without a hearing. AGL understood from the Consultation Paper that the Treasurer's orders were intended to be subject to merits review, and AGL strongly supports this being reinstated in the legislation. AGL also submits that merits review should be available for the ACCC's notices and recommendations. The Draft Legislation should be amended to include additional protections to ensure procedural fairness, including express statutory rights to be provided with the ACCC's recommendations and to be heard by the Treasurer, and guaranteed minimum timeframes to do so.
- **Concerns with specific provisions.** AGL is deeply concerned with the provisions relating to:
  - bidding conduct with the purpose of 'distorting or manipulating price' (sections 153F and 153G) as the practical complexities of determining a line between legitimate participation in the energy only market and prohibited conduct are significant; and
  - the retail pricing prohibition (section 153D) which is determined by reference to retailers' "underlying costs".

These provisions would be inherently uncertain and create an extremely difficult environment in which to undertake the daily operation of an energy business.

- **AGL repeats the submissions it made in response to the Consultation Paper on 8 November 2018.** The Draft Legislation only confirms the concerns AGL expressed in that submission.

AGL will work to provide Treasury with clear illustrative examples of the circumstances in which the application of the new prohibitions will create enormous uncertainty (particularly for vertically-integrated retailers), making it difficult or impossible to determine what is required to comply. This uncertainty will cause significant disruption to the normal commercial operations of electricity businesses.

Finally, the consultation process has been entirely insufficient. AGL is alarmed by the "*extremely short*" timeframe permitted for comments on the Draft Legislation of **just 3 working days**, and the hurried consultation and drafting process more generally. The electricity market is a key pillar of the Australian economy and one of its most complex physical and financial systems. Changes of the magnitude proposed in the Draft Legislation demand careful deliberation and consultation. The industry has not been provided with any cogent policy reasons for the unusually short timeframe for stakeholder engagement on the Consultation Paper and Draft Legislation.

AGL also observes that the concerns raised during the consultation phase have not been addressed in the Draft Legislation. The Commonwealth is seeking to unilaterally and fundamentally alter Australian energy markets and introduce *de facto* retail price regulation without COAG consultation or agreement. Such an approach is contrary to the COAG agreements, and profoundly contrary to the public interest.

Treasury has circulated the Draft Legislation with a direction that it be treated as confidential, although AGL is unaware of any policy reason for that approach. Further, AGL understands that Treasury does not intend to publish any comments on the Draft Legislation, and has not yet published submissions on the Consultation Paper.

This legislation is of the highest importance to AGL, its shareholders and customers, Australian businesses and the Australian public. AGL will not make this submission public at this time, but makes no representation that it will continue to treat this submission as confidential. AGL will be discussing the Draft Legislation with stakeholders and will be making reference to the matters raised in this submission in those discussions.



Yours sincerely,

Beth Griggs  
**General Manager - Competition Regulation & Strategy**



## 1. Executive summary

This submission contains AGL Energy Limited's (**AGL**) response to the exposure draft of the "Treasury Laws Amendment (Electricity Price Monitoring) Bill 2018" (**Draft Legislation**) provided to AGL on 16 November 2018. The Draft Legislation would amend the *Competition and Consumer Act 2010 (Cth)* (**CCA**) to introduce:

- four new prohibitions under sections 153D, 153E, 153F and 153G (**new prohibitions**); and
- new remedies for contraventions of these new prohibitions, which include contracting orders and divestiture orders issued by the Treasurer under Division 5 (**Treasurer's orders**).

The Draft Legislation follows the Australian Competition and Consumer Commission's (**ACCC**) Retail Electricity Pricing Inquiry Final Report (June 2018) (**Final Report**), and Treasury's *Electricity price monitoring and response legislative framework* Consultation Paper (23 October 2018) (**Consultation Paper**).

AGL emphasises that there is no prospect of it responding comprehensively to the Draft Legislation in the "extremely short" timeframe permitted of just 3 working days. Accordingly, AGL repeats the submissions it made in response to the Consultation Paper on 8 November 2018 – the Draft Legislation only confirms the concerns AGL expressed in that submission.

AGL has otherwise sought to focus on the most critical new issues raised by the Draft Legislation. In short, AGL is extremely concerned with the Draft Legislation:

- **AGL has fundamental concerns with the practical application of the Draft Legislation as it will be impossible for companies to comply.** The key operative provisions of the Draft Legislation are so broad and uncertain that it will be impossible for retailers and generators to comply. A number of elements of the Draft Legislation appear contrary to the basic economic principles of energy markets in Australia and gives the ACCC excessively interventionist and highly discretionary powers. For these reasons, the Draft Legislation will have unintended consequences and disrupt the efficient functioning of the electricity market, and on this basis would be against the public interest. There is a significant risk that the introduction of such legislation will deter further investment in new generation capacity, increase prices and potentially impact system reliability.

The retail pricing prohibition (section 153D) will disincentivise efficient conduct to reduce costs. The Treasurer's divestiture orders are disproportionate and punitive, and even the potential for their application will deter much needed investment in generation capacity. In particular, AGL opposes the proposed divestiture remedy in the strongest possible terms. While the Consultation Paper referred to divestiture being applied only "*as a last resort*", the Draft Legislation contains no such limitation. The Draft Legislation is unnecessary given the existing regulatory framework, which ensures effective competition in the energy sector.

Given that the prohibitions will have immediate effect (with no transitional period) and the extreme remedies and penalties available, the Draft Legislation will cause significant disruption to electricity companies' businesses and energy markets. The legislation is so broad and uncertain that the ACCC will be left to bestow meaning, without the discipline provided by merits review. AGL submits that legal norms should reflect the will of the Parliament, and be capable of interpretation by the corporations subject to those norms.

- **The Draft Legislation lacks an appropriate level of procedural fairness and is contrary to the rule of law.** As currently drafted, the Draft Legislation permits the Treasurer to make an order that a private corporation divest its assets without a hearing. AGL had understood from the Consultation Paper that the Treasurer's orders would be subject to merits review. AGL strongly supports such provisions being reinstated into the Draft Legislation, and submits that merits review should also be available for the ACCC's notices and recommendations. The Draft Legislation must include additional protections to



ensure procedural fairness, including express statutory rights to be provided with the ACCC's recommendations and to be heard by the Treasurer, and guaranteed minimum timeframes to do so.

- **AGL has significant concerns with several specific provisions.** AGL is particularly concerned with the provisions in relation to:

- bidding conduct with the purpose of 'distorting or manipulating price' (sections 153F and 153G) as the practical complexities of determining a line between legitimate participation in the energy only market and prohibited conduct are significant; and
- the retail pricing prohibition (section 153D) which is determined by reference to retailers' "underlying costs".

These provisions would be inherently uncertain and create an extremely difficult environment in which to undertake the daily operation of an energy business. The introduction of such provisions risks undermining the competitive outcomes intended by the National Electricity Market (**NEM**) and destroy already low investment incentives.

- **The consultation process has been entirely insufficient.** AGL and others have been afforded little time to respond to this complex Draft Legislation, and Treasury has had no regard for the significant concerns AGL raised during the consultation phase. The Commonwealth is seeking to unilaterally and fundamentally alter Australian energy markets and introduce *de facto* retail price regulation without COAG consultation or agreement. Such an approach is contrary to the COAG agreements, and profoundly contrary to the public interest.



## 2. Fundamental concerns with the practical application of the Draft Legislation

AGL has significant concerns with the broad and uncertain definition of several key terms in the Draft Legislation. It is believed that such ambiguity will create an environment in which it is genuinely challenging or impossible for retailers and generators to know if their day to day actions are in compliance with the law.

A number of elements of the Draft Legislation could reasonably capture a range of rational and appropriate commercial actions that a generator or retailer may take in the ordinary course of conducting their business. In these instances, the legislation is contrary to the basic economic principles of energy markets in Australia and is highly likely to have unintended consequences that disrupt the efficient functioning of the electricity market – impacting the outcomes for both participants and consumers.

Given the compressed timeframe for consultation, AGL has sought to focus on the most critical issues of ambiguity raised by the Draft Legislation and has attempted to outline at a high level the potential consequences of this legislation on the operations of AGL and other market participants. These include:

- **Section 153D retail pricing prohibition.** This prohibition is very broad – it applies to all retailers (whether vertically-integrated or not), for all electricity supplies and offers to supply to mass market customers (residential and small business). A retailer will contravene this prohibition if it fails to make “reasonable adjustments” to the price it supplies, or offers to supply, to reflect reductions in its “underlying cost of procuring electricity”.

Retailers’ “underlying costs” are highly complex and variable across the industry, and extremely difficult to ascertain with confidence for vertically-integrated retailers in particular. Accordingly the Draft Legislation proposes an unworkable standard. To the extent further regulation of retail price is considered necessary (which is a matter already being considered by COAG and the AEMC), it should reference a requirement that retailers give due consideration to the movement in the range of costs a retailer operating in a competitive market might incur, with reference to observable market prices. Without such a standard, the prohibition will undermine the competitive outcomes intended by the NEM and destroy already low investment incentives. In particular, if the term “underlying costs” is interpreted to refer to actual costs (putting aside the difficulty in defining an undisputed view of the relevant definition of cost) then there will be little or no incentive for a retailer (whether vertically-integrated or not) to be efficient. Further, the requirement to pass through any revenue above “underlying costs” will leave a gentainer with no prospect of recovering the cost of their investment in generation, and no incentive to invest.

AGL notes in this respect that there is no clear, certain or uncontroversial approach to ‘underlying cost’ available or capable of calculation, particularly for vertically-integrated retailers. Any approach, whether be it focussed on the leveled costs of generation in the NEM, short run marginal costs of particular generators or regions in the NEM, or on a myriad of other possible formulations of ‘cost’, will have inherent complexities in the calculation, and in the consequences of imposing this standard on the industry.



Further:

- This prohibition appears to assume a complete correlation between wholesale energy costs and consumer prices. However, a reduction in wholesale energy costs may be offset by changes to other components of the retail cost stack.<sup>1</sup>
- Retailers may also face conflicting obligations making compliance impossible, given the prescribed process and permitted timing (typically annually) for changes to standing offer rates under the NERL on which AGL's consumer market offers are based.

Finally, this prohibition does nothing to address the concern identified in the Consultation Paper – “consumers’ confusion about retail electricity offers” and the difficulty of comparing offers. Rather, this prohibition seeks to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and in the long run, increase prices.

- **Sections 153F and 153G – electricity spot market prohibitions.** These provisions apply to ordinary course conduct for generation businesses – both bidding and not bidding (“failing to bid”) – and apply to all generation businesses, not just those that are able to exercise market power. Accordingly, all generators will need to rely on their “purpose” to avoid ordinary course and rational decisions from contravening sections 153F and 153G. However, the relevant purpose provisions are uncertain.
  - The phrase “fraudulently, dishonestly or in bad faith” is unclear, and the Draft Legislation provides no definition. Whatever the exact meaning, this section appears to be duplicative of NEL provisions, including the “Good Faith” bidding provisions.<sup>2</sup> The ACCC and AER will have similar enforcement responsibilities, creating regulatory duplication and the potential for differing compliance standards.
  - The phrase “distorting or manipulating” is similarly undefined and unclear, particularly given that every legitimate bid (or decision to not bid) impacts the relevant spot price.

This prohibition will distort bidding incentives and undermine a fundamental premise of the energy-only NEM, which is that temporary high spot prices allow generators to recover sunk costs and signal the need for investment.

The provision also creates significant uncertainty in the context of complex generator businesses – for example, is there a relevant “failure to bid” where a generator’s plant is unavailable, whether for scheduled maintenance, unscheduled maintenance, or due to unexpected failure?

The basic design and function of the NEM, employing an auction-based clearing mechanism, results in effectively all bids (or withheld bids) impacting the spot price in the market. The practical complexities of determining a line between legitimate participation in the energy only market and prohibited conduct are significant, for example:

- How will the definition of “distorting or manipulating prices” be constrained to exclude the range of rational bidding strategies which purposefully or inadvertently change market prices?
- How would a generator’s true “opportunity cost” of committing scarce fuel resources (including water in the case of hydro) be assessed against the decision to preserve these assets for use at a later point?

The practical issues associated with this proposed provision are immense.

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<sup>1</sup> Other significant and variable retail electricity cost components include regulatory, network, retail and environmental costs.

<sup>2</sup> For example, NEL Clause 3.8.22 and 3.8.22A creates a prohibition on submitting offers, bids and rebids that are false, misleading or are likely to mislead.



- **Sections 153E and 153GA – financial contracts prohibition and imputed purpose.** Any rational participant in financial contract markets will need to limit its offers to enter into electricity financial contracts – for example, where a gentainer's hedge book is full and it lacks the generation capacity to write new contracts. Accordingly, all gentailers will be required to rely on their “purpose” to avoid ordinary course and rational decisions from contravening section 153E.

The relevant purpose can be imputed by inference, including the conduct of any other person.<sup>3</sup> This gives the ACCC significant discretion as to the matters and evidentiary standard that would be sufficient to establish the requisite “belief” of a corporation’s anti-competitive purpose.

- **Section 153P – Prohibited conduct notices.** In order to trigger a Treasurer divestiture order, the ACCC must first issue a notice that it “reasonably believes” that there has been a contravention, that divestiture would be a “proportionate” response, and that divestiture would result in a net public benefit.<sup>4</sup>

The standard of “reasonable belief” is not sufficiently high given the nature of the prohibitions and remedies, and creates significant regulatory uncertainty, particularly in the absence of merits review of the ACCC’s belief and the basis for it. It is unclear to AGL whether the requirements of section 25D of the *Acts Interpretation Act 1901* (Cth) apply to the requirement that the ACCC “explain the reasons why” it holds its belief.

AGL submits that the requirements of section 25D should apply, and that this should be made express for all notices, recommendations and orders given throughout the Draft Legislation.

- **153ZM – Treasurer may make divestiture order.** The Treasurer is required to publish notice of a divestiture order, including the day by which the asset disposal must be made.<sup>5</sup> With the forced sale end date public, a corporation is unlikely to have any prospect of obtaining fair market value for the divested assets.
- **Extension of ACCC’s section 155 powers.** The Draft Legislation provides that the ACCC’s section 155 powers will be available if the ACCC has “*reason to believe that a person is capable of furnishing information, producing documents or giving evidence*” relevant to a Treasurer’s order.<sup>6</sup> The effect of this provision is that the ACCC will be able to exercise its section 155 powers not only to investigate a possible contravention of a Treasurer’s order, but possibly also to monitor compliance.

(The ACCC’s section 155 powers will also be available to investigate potential contraventions of the new prohibitions.)

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<sup>3</sup> Draft Legislation, section 153GA.

<sup>4</sup> Draft Legislation, Section 153P.

<sup>5</sup> Draft Legislation, Section 153ZM(2)(e), (3)(b) and (7).

<sup>6</sup> Draft Legislation, Part 2, Section 11. See CCA, sections 155(1) and (2).



### 3. Overarching concerns with the Draft Legislation

AGL has the following overarching concerns with the Draft Legislation.

- **The key operative provisions are drafted with reference to broad, vague and ill-defined concepts, and are therefore inherently uncertain. Retailers and generators will be unable to attribute meaning to those provisions with confidence, making *ex ante* compliance impossible.**

The manner in which the key operative provisions of the Draft Legislation (in particular, the new prohibitions) are expressed is so broad and open to differing interpretations such that no retailer or generator operating in Australia<sup>7</sup> will be able to determine what they need to do to comply with the legislation. Section 2 discusses a number of specific examples.

In these circumstances, it is entirely inappropriate for the Draft Legislation to only be given meaning by the ACCC through guidelines. Legislation should express the will of the Parliament. It should not be left to the ACCC to determine the fundamental meaning of the Draft Legislation and its practical effect when applied.

- **The Draft Legislation is contrary to the basic economic principles of energy markets in Australia, and will have unintended consequences that are against the public interest.**

The Draft Legislation is likely to undermine the economic incentives towards productive, allocative and dynamic efficiency that the NEM seeks to establish. In particular, AGL notes that section 153D makes no reference to competitive concepts such as “effectively competitive market prices”, which would be necessary to preserve retail competition. (Section 153D is discussed further in Section 2.)

If the Draft Legislation is applied, its effect will be to penalise more efficient businesses and to significantly reduce vertically-integrated businesses’ ability to recover the long-term costs of their generation investments, which will have an unprecedented impact on the proper functioning of the market. This will subvert the premise of the market as an energy-only market, and will significantly reduce incentives to invest in new generation capacity or to remain vertically-integrated, which is an economically efficient market structure to reduce the risks inherent in Australia’s electricity markets. The long-term result is likely to be higher costs of generation, and higher electricity prices to consumers.

- **Draft Legislation gives the ACCC excessive influence and interventionist powers over retail pricing and investment in the Australian energy industry.** The retail price prohibition (section 153D) seeks to circumvent and abrogate the States’ jurisdictional power over retail prices. The States are currently consulting on the introduction of a default retail price, and have requested that the AEMC advise them on the effect such regulation would have on competition. The Draft Legislation would render such consultation redundant, and will give the ACCC significant control over retail price setting.

The Draft Legislation also proposes to give the ACCC the ability to recommend that the Treasurer implement ‘remedies’ (which appear to be more in the nature of penalties) without any recourse to a court. Given the broad and uncertain terms of the Draft Legislation, the ACCC will have significant discretion over how these provisions are interpreted and applied. This discretion gives the ACCC a concerning degree of influence over the operation of the energy market, and therefore a level of control over the investment environment in each jurisdiction.

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<sup>7</sup> AGL notes that the Draft Legislation is not limited to the NEM – see Section 4 below.



The ACCC's Final Report did not recommend the "extreme measure" of a forced divestiture power, and ACCC Chairman Rod Sims has publicly stated that he does not support such a power: "... *my personal view is that divestment is probably not the best way to deal with energy prices...*"<sup>8</sup>

- **Prohibitions are unnecessary given the current legislative framework.** AGL does not believe that there are any deficiencies in the current legislative framework regulating the electricity sector that warrant the intervention contemplated by the Draft Legislation.

The fundamental premise of the new prohibitions is that the prohibited conduct causes market harm. That type of conduct is already prohibited under the CCA. In particular, CCA section 46 prohibits the misuse of market power with the purpose of substantially lessening competition, and CCA section 45 prohibits contracts, arrangements, understandings or concerted practices among competitors with the purpose of substantially lessening competition (without the requirement for market power). Given this comprehensive coverage of harmful anti-competitive conduct, the only additional scope of the new prohibitions is to capture conduct that does not harm the competitive process. Accordingly, the new prohibitions are unnecessary.

Further, section 46 has recently been expanded to cover conduct causing anti-competitive "effects", which remains untested. "Good faith" bidding rules introduced into the National Electricity Rules (**NER**) in 2016 on their face adequately address concerns regarding fraudulent, dishonest or bad faith wholesale bids (and the AER has not commenced any enforcement proceedings under these amended rules).

Accordingly, an effective legal framework for ensuring competitive behaviour by electricity market participants is already in place. The sector is already heavily regulated,<sup>9</sup> and further sector-specific regulation is unwarranted.

- **Given the above, AGL continues to be of the view that the proposed Treasurer's orders are disproportionate and will deter investment.**

In particular, AGL opposes the proposed divestiture remedy in the strongest possible terms. While the Consultation Paper referred to divestiture being applied only "as a *last resort*", the Draft Legislation contains no such limitation.

Providing the Treasurer with the ability to exercise such an interventionist power will distort the proper functioning of the market, particularly given the lack of procedural fairness afforded in the process (see Section 4 below). AGL considers that divestiture is unlikely to ever be a proportionate response to the conduct described in the Draft Legislation. Rather, divestiture is likely to be disproportionate and punitive in nature.

Given the significant uncertainty of these prohibitions, the lack of procedural fairness, and the disproportionate and punitive nature of these remedies, their existence – even if they are never used – will significantly reduce investment incentives in the electricity sector, particularly investment in new large-scale generation capacity.

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<sup>8</sup> See AGL's submission on the Consultation Paper of 8 November 2018, p13-14; Radio National, 31 Oct 2018 – Fran Kelly interviews Rod Sims.

<sup>9</sup> Including under the National Electricity Law (**NEL**), NER and National Energy Retail Law (**NERL**).



## 4. Draft Legislation is contrary to the Rule of Law and lacks appropriate procedural fairness

AGL considers that the Draft Legislation is contrary to the rule of law and lacks the appropriate level of procedural fairness, in at least the following aspects.

- **No merits review.** Despite the Consultation Paper indicating that "*merits review and judicial review would be available for the Treasurer's determinations*", there is no provision in the Draft Legislation that makes merits review expressly available.

This confirms AGL's concerns that there will be minimal oversight of the Treasurer's decisions (as well as the ACCC's decisions and recommendations). Those decisions will not be subject to disallowance by the Federal Parliament.<sup>10</sup> The Treasurer's orders can be imposed without any Court finding that a corporation has contravened the new prohibitions.

AGL submits that, at a minimum, the Treasurer's orders must be subject to merits review. The protections afforded by merits review are essential.

AGL further submits that there should be no limitation on the scope and application of that merits review. In order for the process to be in any way tenable, the ACCC's notices and recommendations would also need to be subject to merits review.

- **No express judicial review.** Despite the Consultation Paper indicating that "*merits review and judicial review would be available for the Treasurer's determinations*", there is no provision in the Draft Legislation that makes judicial review expressly available. The Draft Legislation should expressly provide that the ACCC's recommendations and the Treasurer's orders are judicially reviewable under the *Administrative Decisions (Judicial Review) Act 1977 (Cth)* (**ADJR Act**).
- **Gravity of recommendations and orders.** In any event, judicial review of itself is insufficient given the gravity of the decisions being made and the nature of the decision-making process. First, the ACCC's recommendation is only premised on it having a "reasonable belief". Second, the Treasurer's power is only conditioned on he or she being "satisfied" of various matters, including contravention of the new prohibitions. The magnitude of the intervention permissible under this legislation requires the assessment to be correct, not just based on a "reasonable belief" or the "satisfaction" of a Minister. Judicial review only assesses whether the power was validly exercised. It does not involve a review of whether the decision-maker made the correct or preferable decision.  
  
Further, given the limited time for the ACCC's and Treasurer's decision-making (see below), there may be insufficient time for a judicial review application to be heard and determined by a court. While an injunction may be sought, those orders are discretionary and accordingly uncertain. The express provisions that provide for ADJR Act review should also provide for sufficient time in which that may occur.
- **Insufficient time to respond to ACCC notice, and no minimum time to respond to ACCC recommendation or before Treasurer makes order.** The Draft Legislation provides just 45 days for a corporation to respond to an ACCC prohibited conduct notice.<sup>11</sup> At any time thereafter, the ACCC may

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<sup>10</sup> The Draft Legislation expressly provides that the ACCC's notices and recommendations are not legislative instruments and accordingly not subject to disallowance. See Draft Legislation, Sections 153J(3), 153K(4), 153P(6), 153Q(5), 153R(6), 153S(7), 153T(4), 153U(11). While the Draft Legislation is not express, it is clear as a matter of statutory interpretation that the Treasurer's orders are not subject to disallowance.

<sup>11</sup> See Draft Legislation, Section 153P. The ACCC may allow a later day (Section 153P(3)) or vary the notice (Section 153Q), but there are no provisions dealing with extensions to this period nor the factors or standards relevant to any ACCC decision to allow a later day or vary a notice.



issue a prohibited conduct recommendation to the Treasurer (and has 45 days to do so),<sup>12</sup> and the Treasurer may then make the recommended order at any time (and has 45 days to do so).

Accordingly, a corporation is guaranteed **just 45 days** to respond to the ACCC's "reasonable belief" of the contravention and its proposed remedies (which may include divestiture) before an order is imposed. A corporation is guaranteed **no opportunity or minimum time** to respond to the ACCC's prohibited conduct recommendation, nor to make representations to the Treasurer.

The timeframes for this process lack any semblance of adequate procedural fairness and are contrary to the rule of law. The Draft Legislation permits an order to be made divesting a private corporation of its assets without a hearing.

- **Corporation not guaranteed notice of the conduct and information before Treasurer, nor the recommended remedies.** The Draft Legislation contains no provision requiring the corporation to receive a copy of the ACCC's prohibited conduct recommendation to the Treasurer. Accordingly, the corporation will have no certainty that it will be provided the information before the relevant decision-maker (the Treasurer) about the alleged conduct, nor the remedies proposed (and by extension, the range of decisions that the Treasurer might make), nor the reasons and factual matters supporting each aspect of the ACCC's recommendation.

Further, section 153R(3) expressly contemplates the ACCC changing its proposed remedy/ies as between a notice to the corporation and its recommendation to the Treasurer. In those circumstances, the corporation would be afforded no notice at all of the proposed remedy/ies and no guaranteed opportunity or minimum time to respond to that remedy and the factual matters said to support it (see above).

The Draft Legislation does not contemplate the Treasurer seeking any further information to support his or her final decision or requirement to give the affected corporation an opportunity to be heard. As noted above, none of these decisions are reviewable on the merits as currently drafted. This is an extraordinary position given the nature of the prohibitions and the remedies available. The process is opaque and contrary to the rule of law.

- **Penalties excessive, given uncertainty of new prohibitions.** The new prohibitions will be subject to the CCA civil penalty regime with maximum fines of \$10 million, 10% turnover or 3 times the benefit. This same penalty regime applies to deliberate anti-competitive conduct, including (for example) non-criminal cartel conduct. Yet, the new prohibitions could be triggered by actions that lack any anti-competitive intent – for example, a failure to sufficiently reduce the price of electricity following a reduction in wholesale costs,<sup>13</sup> or a single "bad faith" failure to bid 1MW of available capacity that has no material impact on spot prices.<sup>14</sup>

Further, section 153L increases the applicable penalty for an infringement notice by a factor of 10, to 600 penalty units (currently \$126,000). Such infringement notices are in practice difficult to challenge, particularly where the threat of an even more onerous remedy remains. In this context, these penalties are excessive.

- **No transitional period.** The prohibitions and penalties will apply immediately on royal assent, and to current conduct that continues to occur after that date.<sup>15</sup> This affords almost no time for AGL or other market participants to review the legislation as passed, obtain advice on its interpretation, effect and interaction with the NEL, NER, NERL and other applicable laws and regulations (which AGL anticipates will be subject to significant uncertainty), review their policies and procedures, and implement the

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<sup>12</sup> Draft Legislation, Section 153QA.

<sup>13</sup> Draft Legislation, Section 153D.

<sup>14</sup> Draft Legislation, Section 153F.

<sup>15</sup> Draft Legislation, Section 2 (Commencement) and Section 13 (Application).



required changes. AGL anticipates inconsistencies between the new prohibitions and other CCA prohibitions.

AGL's business and its operating environment is highly complex. The Draft Legislation will require profound changes to AGL's business that will require careful consideration and more time to implement than the Draft Legislation allows.

- **Over-broad application, including beyond the NEM.** The Draft Legislation is not limited to the NEM, but applies to any markets (i) "*in relation to the supply of electricity*" and (ii) "*for electricity financial contracts*", being any contract where "*rights ... are derived from or relate to the price of electricity on an electricity spot market*".<sup>16</sup>

The effect of these definitions is that the Draft Legislation prohibitions are likely to apply to electricity markets other than the NEM. It is not clear to AGL why the Draft Legislation is intended to have application beyond the NEM.

Further, the over-broad definition of "electricity financial contract" means that the financial contract liquidity prohibition<sup>17</sup> will likely apply beyond contracts between gentailers and non-vertically integrated retailers – for example, to contracts with large customers, hedge contracts between two generators or gentailers, OTC trades with financial counterparties, power purchase agreements, outage and weather-linked contracts with insurance companies and electricity futures.

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<sup>16</sup> Where the market operator is not a party to the contract.

<sup>17</sup> Draft Legislation, Sections 153E.



## 5. Insufficient consultation

Treasury permitted just 12 working days (11 taking the Melbourne Cup holiday into account) for comment on the Consultation Paper.<sup>18</sup>

The Draft Legislation was released just 7 working days later, which indicates to AGL that little or no account was taken of the significant concerns expressed by various stakeholders. Neither AGL's nor other respondents' submissions on the Consultation Paper have yet been made public.

Treasury has now permitted **just 3 working days** to comment on the Draft Legislation, and has stated upfront that it is "*unable to extend the consultation period*". Such a short period is both highly unusual, and entirely insufficient for AGL and others to meaningfully comment on draft legislation of such importance and complexity. Neither Treasury nor the Government have provided any cogent policy reasons for the unusually short timeframe for stakeholder engagement on the Consultation Paper and Draft Legislation.

Further, the Draft Legislation indicates to AGL that the Commonwealth is seeking to unilaterally legislate to fundamentally change the electricity market without COAG consultation or agreement. This is contrary to the COAG agreements, and to decades of cooperative and iterative changes to Australia's electricity sector by agreement between the States and Commonwealth, in consultation with the industry and regulators. In particular, the Australian Energy Market Agreement (**AEMA**) unequivocally provides that amendments to energy policy and governance should only be made in consultation with COAG,<sup>19</sup> and that the AER (not the ACCC) should be responsible for the regulation of retail energy markets.<sup>20</sup>

On this basis alone, the Commonwealth's actions are profoundly against the public interest. Indeed, the Commonwealth has itself previously criticised the States for seeking to take unilateral action that would affect energy markets (in the context of renewable energy targets).<sup>21</sup>

AGL is extremely concerned with the deficiencies of this consultation process, particularly given the gravity of the amendments proposed.

The introduction of such complex provisions and interventionist enforcement provisions, which are contemplated to be exercised by the ACCC and the Treasurer (not a court, and without recourse to merits review), should only be considered in the context of comprehensive and careful consultation. In AGL's view, the Draft Legislation is being progressed in a manner that is completely inappropriate given the fundamental impact it will have on the operation of the energy industry, ongoing investment in new generation capacity and the Australian economy as a whole.

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<sup>18</sup> Although AGL understands that Treasury accepted submissions for approximately a week after that date.

<sup>19</sup> See AEMA, sections 4.1, 4.3, 6.6 and 6.7.

<sup>20</sup> See AEMA, sections 5.1(b) and 9.1(e).

<sup>21</sup> For example, see <https://www.afr.com/news/politics/victorian-clean-energy-target-could-shut-yallourn-says-josh-frydenberg-20180115-h0idwf>.