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Electricity price monitoring and response legislative framework

The Australian Energy Council (the "**AEC**") welcomes the opportunity to make a submission to the Government's Consultation Paper on the Electricity price monitoring and response legislative framework (the "**Consultation Paper**"). The AEC is the industry body representing 22 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEC has also included at Attachment 2 a legal opinion on the Consultation Paper provided by the Ashurst legal firm.

Introduction

The AEC does not support the proposed electricity price monitoring framework as outlined in the Consultation Paper. The AEC considers that measures outlined in the Consultation Paper introduce unnecessary duplication to existing laws, create uncertain obligations on whether behaviour is or is not prohibited conduct and creates an unpredictable enforcement regime which will negatively impact competition and investment.

The prohibited conduct described in the Consultation Paper is inferred to be so significant that it requires new legislation in addition to the laws already governing the energy market. Conduct provisions specific to the energy industry are being proposed to be housed in the Competition and Consumer Act (CCA), outside of the regulatory framework governing energy. This can only create uncertainty. The clear obligations contained in the National Electricity Law and the National Energy Retail Law (the Energy Laws) will become more difficult to comply with if the new obligations set out in the Consultation Paper are introduced. Certain behaviour, already regulated in a different manner in the Energy Laws may fall under the new prohibited conduct provisions. The Consultation Paper provides no clarity on how potential conflicts between these frameworks should be managed.

The AEC strongly opposes sector specific conduct provisions. Legislating extreme penalties to a particular industry without any evidence or suggestion of genuine market failure is egregious, and will add further uncertainty, chilling investment in energy infrastructure that is so crucial to delivering lower prices to consumers. The presence of a unilateral divestment power in the hands of the Treasurer will significantly impact the investment environment in Australia. We note that the Australian Competition and Consumer Commission (ACCC) found no evidence in its report that such a power is required.[1] In addition, the consultation paper provides no information on how this power might be used. This will significantly add to sovereign risk and become an important consideration for financiers who might otherwise have invested in the Australian energy market.

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

[1] ACCC '*Retail Electricity Pricing Inquiry – Final Report June 2018*' p. 89.

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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.

No element of the prohibited conduct provisions described in the Consultation Paper has been borne from any evidence of market failure so significant that the types of remedies proposed are necessary. The prohibited conduct described are speculative, rather than being targeted to highlight any pronounced shortcomings in the existing regulatory structure. They will not deliver consumers any genuine reduction in energy prices in the long term as they do not address the drivers of high prices: under-investment due to policy uncertainty.

The nature of the prohibited conduct provisions

The Consultation Paper proposes four actions it considers would deliver unacceptable outcomes. These actions are vague at best, and at the very least subjective and difficult to enforce. Complicating matters further, 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. The prohibited conduct outlined in the Consultation Paper is neither clear nor consistent. Conduct which may be in the interest of competition may fall under one of the prohibited conduct proposals or it may not; there is no detail or clarity provided.[2] This will have negative impact on current participants in the market and will discourage new investment at a time when it is sorely needed in order to reduce prices.

The structures of competitive markets are critical, ultimately determining market participant conduct and market performance. The rules underpinning them should be improved wherever shortcomings can be clearly identified. However, due to the risks of unintended outcomes, drastic interventions without proper consultation should be avoided. Merely prohibiting actions the market design intended for will deliver adverse outcomes.

Further comments regarding each prohibited conduct provision are included in Attachment 1.

The National Electricity Objective (NEO)

The AEC understands that legislating electricity specific powers into the CCA means that an assessment as to whether or not the changes meet the NEO is avoided.

The NEO sets out that the regulatory framework is designed to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers. We do not see how the implementation of a prohibited conduct framework of the nature described in the Consultation Paper could achieve this.

Furthermore the presence of high prices are not, in themselves, an indicator of a need for market correction, particularly in the generation market. As the ACCC reported in its Retail Electricity Price Inquiry, "To the extent that higher prices are being driven by a tighter supply-demand balance, and these conditions are forecast to persist, we would expect these price signals to lead to an investment response".[3]

Appropriate Compliance Frameworks

The legislative framework proposed by the Consultation Paper risks creating a compliance structure that fundamentally lacks clarity for participants. Electricity businesses will be required to ensure compliance with the regulatory frameworks currently regulated by the Australian Energy Regulator, and at the same time ensure

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[2] See attached Ashurst advice at 4.2
[3] Australian Competition & Consumer Commission, *Retail Electricity Pricing Inquiry – Final Report*, June 2018, p.98

that the manner in which these obligations are complied with does not create the appearance that the conduct provisions, regulated by the ACCC, might be breached.

The ACCC would have the power to make an assessment that it considered the conduct of the business constituted prohibited conduct under the CCA. As noted above, consideration as to whether or not a breach occurred will be necessarily subjective, with the only opportunity for the Electricity Business to state their 'defence' being a submission sent to the ACCC detailing why they don't consider a breach occurred.

Given the subjectivity of the conduct in question, and the extreme nature of the potential remedies, this process is clearly inadequate.[4]

Compliance obligations must be clear, timely and proportional. This allows Electricity Businesses to understand the operating limitations within the market rules to deliver optimal outcomes to consumers. The penalty regime described in the Consultation Paper will create grey areas around these boundaries, forcing actions that are more conservative than they otherwise would be, to the detriment of economic efficiency. Signals will be softened, and while overt misconduct might be avoided, the result may be that the average outcome is worse than it may otherwise have been.

The structures of the market create additional complexities. The proposal would appear to apply to all electricity markets. However the rules and ownership structures in different markets are entirely different, for example:

- Tasmania is strictly regulated under an existing state power;
- the WEM has its own arrangements and local regulations; and
- NWIS and smaller grids intentionally have no or only a very limited role for competition.

These structures must all be considered when implementing any blunt changes to the compliance frameworks.

Available Remedies

The Consultation Paper described vague obligations, leading to complicated and subjective compliance requirements, and ultimately significant remedies. The remedies proposed are not proportional to the prohibited conduct they seek to avoid.

Public warnings, infringement notices, and civil penalties are all commonly used by the ACCC as part of their regulatory framework, and for certain conduct, may be appropriate in ensuring Electricity Businesses act in accordance with their obligations. We would not oppose these types of remedies under normal circumstances, where a clear issue in the market had been proven to be delivering unacceptable outcomes for electricity consumers. But such a failure has not been identified and proven in this instance.

Other penalties, in particular the three Treasurer ordered powers to set a price cap, to mandate contracting, and divestiture create significant risks for electricity businesses, and will create the perception of political influence over the competitive market. The scope of these powers are unprecedented, and are not appropriate in any industry absent evidence of market failure of the highest order.

The attached advice from Ashurst (Attachment 2), goes into more detail on the appropriateness of the remedies proposed.

Conclusion

The AEC accepts that change is required to the electricity regulatory frameworks to ensure they continue to deliver positive outcomes for consumers. These changes must be developed with the intention of encouraging investment, increasing competition, and lowering prices. A new penalty regime will not deliver any of these outcomes.

To ensure that any new penalty regime developed out of this consultation achieves positive customer outcomes in the long term, the AEC considers that comprehensive cost benefit and regulatory impact assessments must be conducted immediately. This is particularly critical in this instance, given the new penalty

[4] See Ashurst advice at 3.2

regimes proposed is unprecedented in Australia, and has been developed absent any recommendation or advice.

Attached to this submission are the AEC's specific views on the prohibited conduct provisions (**Attachment 1**), and further legal advice regarding the appropriateness and proportionality of the changes proposed (**Attachment 2**).

Any questions about this submission should be addressed to Oliver Williams, by e-mail to Oliver.Williams@energycouncil.com.au or by telephone on (03) 9205 3111.

Yours sincerely

Sarah McNamara
Chief Executive

Attachment 1: Specific comments on the prohibited conduct proposed

Retail prices

Option A:

Option A appears in practice to change the nature of the default market offer as it was proposed in the ACCC report. The default market offer (DMO) is not intended to cap market offer prices, but rather to ensure that customers on existing standing offer prices are not charged a premium for their disengagement, and to act as a reference point in which all discounts would be measured. To this end, it is intended to be a tool to encourage engagement rather than one to dictate the prices charged by retailers.

The benefits Option A over and above the current regulatory framework are unclear. The National Energy Retail Rules already prohibit retailers discounting off inflated base rates (the discounting rule). In their final decision in May 2018, the AEMC expressly limited application of this rule so that it did not inhibit innovation.

The outcome of option A is that the DMO would represent a cap in the market price, unless a retailer could prove that their offer was materially different to the DMO itself. The Consultation Paper does not give any examples of any conduct that might be non-compliant with this requirement.

Option A clearly represents strict price re-regulation in practice. Unless a retailer was offering a supplementary product or service alongside the energy tariff, it would be difficult to argue that the terms and conditions of the offer would be *substantially different* to the terms of the DMO.

This creates significant risks for retailers, in particular smaller retailers. If the DMO is set too low, and retailers cannot recover their costs, they will be driven out of the market to the overall detriment of consumers.

Strict price regulation for competitive energy has proven to result in poor outcomes for energy consumers both globally and in Australia. There is less engagement, fewer challenger brands, and higher market share for incumbents retailers who have greater economies of scale. Smaller retailers in price regulated jurisdictions face much greater challenges in delivering innovative products customers want, resulting in a decline in overall service, and more customers paying higher prices. This is not in the long term interests of Australian consumers.

Option B:

Enforcing this obligation would be almost impossible. Retailers operating within the highly competitive energy market price their offers to meet a number of objectives. Firstly, as noted by the ACCC, there is a certain level of scale required to achieve sustainability. New entrant retailers must ensure their pricing allows them to grow to the necessary size quickly, resulting in them often pricing their offers significantly below cost. From there, retailers must ensure that their pricing structure, even more so than their cost structure, meets the market. What this means is that even if a retailers cost structures would require them to price their offers above market price, they cannot. To avoid sacrificing all scale already achieved retailers must price their offers at market price, and then work behind the scenes to restructure their costs to achieve sustainability. The final impact when setting prices is the retailers risk profile and exposure in the wholesale market. As noted by the ACCC, retailers charge customers a flat price, yet buy energy at the spot. This creates a significant risk for which retailers develop hedging strategies to mitigate. These strategies change over time, depending on the level of risk a retailer is willing to take. The prohibition in Option B runs contrary to a competitive market as it removes retailers' incentive to attain efficiency gains.

Requiring a retailer to pass on wholesale price decreases disregards the practical operation of the market. The ACCC as regulator would be required to assess all historical pricing, cost, and strategic inputs of a retail business in order to determine if the true costs of generation are being passed through. This is not efficient,

nor warranted in a competitive market. Increasing compliance in this space will only serve to increase risk, and likely to require retailers to operate more conservatively than they otherwise might have in order to avoid penalty.

Until a sustained market failure is identified, this prohibition is unnecessary.

Wholesale bids and conduct

The Consultation Paper identifies a need to prevent conduct in the wholesale spot market which is anti-competitive and can lead to an increase in prices which flows through to end consumers.

An integral feature of the National Electricity Market (**NEM**) is its ability to experience high-priced events (up to the market price cap which is set at $14,200/MWh). Although high priced events are relatively rare, they provide the necessary revenue for peaking generators to switch on and enable base-load stations to bid at or below Short Run Marginal Cost for much of the time. Most importantly, high prices raise the volume weighted pool price and provide the signal for new investment and new competitors. As such, by design, the energy-only National Energy Market may not be a perfectly competitive market, but as determined by the Australian Energy Market Commission (**AEMC**) through the Market Power rule change,[5] the practical assessment for the NEM is whether it is "workably competitive". In its assessments, the AEMC has determined that NEM is a workably competitive market.

Price spikes are essential in an energy-only market to support sufficient generation capacity, including at the extreme peaks of demand, and to enable more regularly dispatched generators to earn sufficient revenue to cover their fixed costs, which can be a significant proportion of their total costs. Generation dispatched to meet occasional peaks in demand may not be required for the majority of the year and must be able to earn sufficient revenue when it does run to contribute to its year round fixed costs.

The best market design is a perennial question, but at the current time the effects of the sustained lack of a national and integrated approach to climate change policy clouds any proper assessment of market competitiveness.

As a result of the perceived need, the Consultation Paper contemplates implementing a prohibition on electricity generators acting fraudulently, dishonestly or in bad faith with the purpose of distorting or manipulating prices. To the AEC, the test of "with the purpose of distorting or manipulating prices" is very vague, difficult to assess and likely to inhibit generators making efficient trading decisions. The effect of this will be to potentially prohibit the behaviour the government sees as virtuous – "behaviour which takes advantage of periods of high prices (which, over time, should be a signal to investors)". The prohibitions proposed in the Consultation Paper will only add to confusion in the market and will not encourage more efficient outcomes for consumers.

Furthermore, under the *National Electricity Amendment (Bidding in Good Faith) Rule 2015* rule change,[6] clauses 3.8.22 and 3.8.22A of the National Electricity Rules were amended to prohibit generators making false or misleading offers in their bids or rebids. The rule change took effect on 1 July 2016, and subsequently the AER has reported in its NSW Electricity Market Advice[7] and its Hazelwood Advice[8] that where high wholesale prices do occur, they are justified by legitimate market circumstances and are not a result of the inappropriate or opportunistic exercise of market power. This view was further reinforced by the AEMC's ministerial response regarding Gaming in Rebidding[9].

On this basis the AEC does not believe that the proposed prohibition is warranted, given there is no evidence of market distortion, and the existing National Electricity Rules already include specific restrictions on generator behaviour.

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[5] Australian Energy Market Commission, *Potential Generator Market Power in the NEM Final Rule Determination*, 26 April 2013
[6] Australian Energy Market Commission, *Potential Generator Market Power in the NEM Final Rule Determination*, 10 December 2015
[7] Australian Energy Regulator, *AER Electricity Wholesale Performance Monitoring – NSW Electricity Market Advice*, December 2017
[8] Australian Energy Regulator, *AER Electricity Wholesale Performance Monitoring – Hazelwood Advice*, March 2018
[9] Australian Energy Market Commission, *Gaming in rebidding (Grattan response)*, 28 September 2018

Contract liquidity

The stated objective of this limb is to target conduct whereby a generator unreasonably refuses to offer contracts to a rival for anti-competitive purposes. To the AEC's mind, this conduct is already prohibited under section 46 of the *Competition and Consumer Act* and nothing would be achieved by adding further prohibitions. The AEC is particularly concerned that the proposed prohibition extends to all generators, not just those in a position of market power. Smaller generators will have different risk profiles and risk appetites, and therefore an assessment that a generator is restricting the availability of electricity financial contracts may be misconstrued, when the reason for a generator to do so is the legitimate protection of its ongoing financial viability and asset utilisation.

On this basis the AEC opposes including additional prohibitions such as those proposed in the Consultation Paper.

Attachment 2: Ashurst Advice on electricity price monitoring and response legislative framework

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Our ref: TLD\JDJ\1000 033 121

07 November 2018

MEMORANDUM

ADVICE ON ELECTRICITY PRICE MONITORING AND RESPONSE LEGISLATIVE FRAMEWORK

1. EXECUTIVE SUMMARY

The Commonwealth Treasury is seeking submissions on the "Electricity Price Monitoring and Responsive Legislative Framework Consultation Paper" (**Consultation Paper**) released on 23 October 2018. Given the gravity of the reforms, the submission period has been very short, closing on 7 November 2018.

This document sets out our advice, prepared for the Australian Energy Council (**AEC**), on the legal issues arising from the matters raised in the Consultation Paper. We have sought to limit our advice to legal questions, but the delineation between legal and policy questions is not always clear cut and therefore, to the extent this advice may be viewed as addressing a question of policy, it should be read as reflecting our view and not necessarily the views of the AEC.

In summary, our view is that the proposed prohibition on a retailer charging more than the default offer unless justified by a substantial difference in terms would practically amount to price regulation in most cases, as it is more likely that price differences would be driven by differences in costs to a retailer and customer preferences, rather than differences in terms. Similarly, the requirement that electricity retailers must adjust prices to reflect sustained decreases in wholesale market costs would operate to cap prices to the levels that apply when the prohibition is introduced (subject, potentially, to increases where wholesale market costs or other costs increase).

It appears to us that these prohibitions go beyond the stated objective of consumers' confusion about retail electricity price offers and the difficulty in identifying and switching to better deals.

We also consider that the proposed wholesale bids and conduct prohibition and prohibition with respect to contract liquidity regulate conduct that is already largely (if not entirely) captured by the bidding requirements in the National Electricity Rules and prohibition against misuse of market power in the *Competition and Consumer Act 2010* (Cth). The introduction of new regulation, with very serious enforcement consequences, should be proportionate to the misconduct. Our view is further work needs to be done to ensure that is the case.

Our most serious concerns are with respect to proposed enforcement powers of the Australian Competition and Consumer Commission (**ACCC**) and Treasurer. In particular, we have concerns about the framing and constitutionality of the Treasurer's remedies in respect of the proposed prohibited conduct, that is, the power for the Treasurer, on recommendation by the ACCC, to impose temporary price regulation on energy retailers, require generators to contract with third parties, and require firms to divest assets. Our view is that if these quasi-judicial powers are to be introduced, then they should be exercised independently so that the decision-making process is not influenced by the potential for political interference (or the appearance of political interference). It will also

be necessary to establish clear principles upon which any such powers are exercised, so that judicial and merits review can be meaningfully applied to a final decision.

2. BACKGROUND

In July 2018, the ACCC released the final report of its "Retail Electricity Pricing Inquiry" (**Inquiry**). The purpose of that Inquiry was to investigate the competitiveness of retail electricity markets and the wholesale electricity market (to the extent it affects retail markets).

In August 2018, the Commonwealth Treasurer announced that the Commonwealth government would implement a package of measures to address the ACCC's recommendations.

On 23 October 2018, the Commonwealth government released the Consultation Paper, alongside a policy announcement entitled "Affordable, reliable power for Australians",[1] to announce and obtain feedback on its proposed measures.

The measures include:

(a) new prohibitions on certain conduct in relation to retail prices, wholesale bids and conduct, and contract market liquidity (**Prohibited Conduct**)[2];

(b) a series of powers for the ACCC and the Commonwealth Treasurer to enforce the prohibited conduct provisions.[3] The ACCC will have the power to issue a public warning notice, an infringement notice and to seek a civil penalty in a court. The Treasurer will, upon recommendation of the ACCC, have the power to set a price cap, and to order an energy company to offer generation capacity or to divest assets (**Remedies**).

The Consultation Paper indicates that the Prohibited Conduct and Remedies will be implemented under the *Competition and Consumer Act 2010* (Cth) (the **CCA**).[4]

2.2 Instructions for advice

The Australian Energy Council (**AEC**) has asked us to provide high level advice in relation to the proposed powers and prohibitions contained in the Consultation Paper.

The AEC has instructed us that its objective is to consider this advice in the context of preparing its written submissions on the Consultation Paper to the COAG Energy Council.

3. PROHIBITED CONDUCT – RETAIL PRICES

3.1 Background

The Consultation Paper seeks submissions on the framing of two retail prices prohibitions:

(a) Option A - an electricity retailer must not charge its small customers a price that is higher than the default market offer unless justified by a substantial difference in the terms and conditions of the offer; and

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1 See https://www.energy.gov.au/government-priorities/affordable-reliable-power-australians

2 Consultation Paper, p. 4.

3 Consultation Paper, pp. 5-6.

4 Consultation Paper, p. 2.

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(b) Option B - an electricity retailer must adjust the prices charged to its small customers to reflect sustained decreases in wholesale market costs.[5]

We understand that the "default market offer" will include a price that is determined by the Australian Energy Regulator (**AER**), and that the AER has been tasked with developing that price.[6]

The Consultation Paper states that the objective is to target retailer conduct which takes unfair advantage of consumers' confusion about retail electricity price offers and the difficulty in identifying and switching to better deals.

3.2 Does the prohibition meet the objective?

Our view is that there is a mismatch between the way the prohibitions are framed and the stated underlying objectives.

The prohibitions effectively amount to a form of price regulation, and so instead of addressing the stated issue (that is, customer confusion and ability to identify better offers), they go further and effectively cap prices. To that end, there is not a clear nexus between the stated issue and the prohibitions ultimately proposed.

This also goes further than the ACCC's recommended default offer regime, which was to establish "a premium offer with additional safeguard features that come at a cost",[7] and to replace the existing standing offers regime.

The proposed prohibition under option A establishes a price cap unless a retailer is able to justify a higher price based on a substantial difference in terms and conditions. There appears to be an unstated assumption that the difference in terms and conditions would make it more expensive for the retailer to make that supply, therefore justifying the higher price. However, the costs in relation to different customer groups are not necessarily the same, and those differences in costs may not be reflected in terms and conditions.

The proposed prohibition under option B is less intrusive, but practically would appear to require that unless wholesale market costs or other costs increase, then prices must remain the same, unless wholesale market costs reduce, in which case they must be reduced accordingly.

It may also be difficult to apply in practice. This is because it appears that the legislation will require, in effect, a backward looking assessment of wholesale costs in order to identify whether there have been "sustained decreases" in wholesale costs that must be passed through to customers through price adjustments.

As explained in the Inquiry Report, electricity prices are set in each NEM region through the wholesale spot market. However, small customers do not pay this price. Instead, energy retailers manage small customer risk by fixing retail prices and managing risk through wholesale purchases of large quantities of electricity, and hedging price and volume risk through wholesale energy financial contracts.

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5 Consultation Paper, p. 4.

6 Australian Government, "A Price Safety Net", https://www.energy.gov.au/sites/g/files/net3411/f/price-safety-net-enr059d.1018.pdf

7 Inquiry Report, p.249.

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The cost of spot prices are public, as are ASX prices, but the costs under financial contracts are not transparent, particularly through the bilateral over-the-counter (**OTC**) contracts (which are not disclosed).

This means there may be a mismatch between how wholesale energy is procured, and the price impact of those procurement arrangements, and the regulated conduct. This carries the risk that:

(a) the prohibition will have unintended effects (for example, it may require retailers to reduce prices in circumstances where they have already committed to a more expensive cost position, and may lead to more conservative higher pricing to manage the downside risks);

(b) the prohibition may be difficult to comply with without clear guidance as to how a "sustained decrease" in wholesale market costs is to be identified; and

(c) for the same reasons, the prohibition may be difficult to enforce, with the potential for considerable argument about the wholesale cost measures.

While ultimately a matter of policy, we consider that less intrusive reforms could be implemented to address the stated objective, which is essentially to make price comparison easier. This could be achieved through the publication of a clear methodology for calculating a reference price (for example, an annual cost for a family home with a specified energy usage profile, including shape and location), so that energy price advertising can be compared to a common benchmark, similar to the recommendation 50 of the Inquiry Report.

4. PROHIBITED CONDUCT – WHOLESALE BIDS AND CONDUCT

4.1 Background

The Consultation Paper seeks submissions on framing a prohibition that 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.[8]

The Consultation Paper also indicates that this prohibition is not intended to change the design and operation of the wholesale markets, stating that the Government is considering how best to distinguish between behaviour which takes advantage of periods of high prices and behaviour which seeks to manipulate or distort prices in a way not intended by the design of the relevant wholesale market.

4.2 Does the prohibition meet the objective?

It is not clear why this proposed prohibition is necessary, given the existing regulation of dispatch offers and bids in Chapter 3 of the National Electricity Rules. One of these is a prohibition on making an offer, bid or rebid that is false, misleading or likely to mislead.[9] An offer, bid or rebid may be false or misleading if the generator does not have a genuine intention to honour, or does not have a reasonable basis to make, the representation.

This was introduced to *replace* the previous "good faith" requirements on the basis that it would establish a more objective basis on which the AER, and subsequently a court, would

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8 Consultation Paper, p. 4.

9 National Electricity Rules, rule 3.8.22A(a).

be able to infer a generator's intent from an individual offer or pattern of behaviour over time, assisting in the interpretation and practical application of the rules.[10]

This prohibition in the National Electricity Rules captures more conduct than the proposed prohibition, because it applies to statements made without a reasonable basis, not just those made fraudulently, dishonestly or in bad faith, and without the additional layer of establishing a "purpose" of manipulating or distorting the market. The prohibition in the National Electricity Rules is also easier to prove because it does not require evidence that the purpose of the offer, bid or rebid was to distort or manipulate prices.

Of course, the proposed prohibition will be subject to the enhanced enforcement powers discussed later in this paper, which go considerably beyond the present prohibitions in the National Electricity Rules.

The introduction of the purpose requirement may also make the rule practically harder to interpret and, in turn, apply. The expression "distorting or manipulating" prices, particularly read with the requirement for the generator to act fraudulently, dishonestly or in bad faith, suggests that the purpose of the behaviour is to alter price outcomes in the market, presumably compared to the prices that would be expected given the prevailing balance between supply and demand and taking account of each generator's costs. However, it may be difficult to practically separate opportunistic, but legitimate, bidding behaviour to take advantage of higher prices (including, for example, to offset previous losses) or validly test market appetite for price changes, from illegitimate behaviour that distorts or manipulates prices in some way.

It is therefore difficult to see how this proposed rule will affect conduct in a manner that will promote the stated objective, given the existing requirements in Chapter 3 of the National Electricity Rules.[11]

5. PROHIBITED CONDUCT – CONTRACT LIQUIDITY

5.1 Background

The Consultation Paper seeks submissions on framing a prohibition that 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.[12]

The stated objective is to target conduct whereby a generator unreasonably refuses to offer contracts to a rival at the retail level for anti-competitive purposes. The Consultation Paper states that this prohibition is not intended to interfere with efficient risk management strategies by electricity market participants, and is not intended to extinguish existing contractual rights (but does not propose any protections in relation to them).

5.2 Does the prohibition meet the objective?

The CCA contains a range of prohibitions against conduct that has the purpose or likely effect of substantially lessening competition, particularly the prohibition against a misuse of market power in section 46.

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10 Australian Energy Market Commission, Final Rule Determination: National Electricity Amendment (Bidding in Good Faith) Rule 2015, 10 December 2015.

11 In addition, the provisions of section 1041C of the *Corporations Act 2001* (Cth) regulating fictitious and artificial transactions may be relevant.

12 Consultation Paper, p. 5.

The Consultation Paper does not establish why the existing prohibition against misuse of market power, which was reformed late last year, is not adequate to deal with this conduct.[13] Given the reforms were made recently, and the fact they are enforced by the ACCC which is scrutinising the electricity sector closely, it would seem premature to make further electricity-specific reforms now, especially in circumstances where the ACCC did not identify this as recommendation in the Inquiry.

Of course, there are differences between section 46 and the proposed prohibition. The key differences are that:

(a) unlike misuse of market power, the proposed prohibition does not require the generator to have a substantial degree of market power in a market and instead regulates the behaviour of all generators based on purpose, without any regard to effect—the exclusive focus on purpose suggests that there is no scope for inquiry as to whether conduct alleged to breach the law would be likely to actually substantially lessen competition; and

(b) the proposed prohibition will be subject to the enhanced enforcement powers, addressed later in this paper.

It is not clear why it is necessary for the proposed prohibition to apply to all generators, irrespective of the extent to which the generator may have market power. While the removal of that requirement may make the prohibition easier to enforce, as a matter of principle, if a generator does not have substantial market power, then in our view it is unlikely to have any ability to unilaterally affect anti-competitive outcomes. To impose this requirement, coupled with the very significant proposed enforcement powers, does not in our view appear to be justified.

6. ENFORCEMENT – ACCC REMEDIES

6.1 Background

The ACCC will have powers to issue public warning notices, infringement notices, and seek civil penalties for breaches of the prohibited conduct provisions.[14]

6.2 Advice

Public warning notices

Public warning notices are appropriate where notifying the public about misconduct will assist in avoiding consumer detriment. This is potentially the case if a retailer is breaching a retail pricing rule, but the benefits are less clear in relation to the other prohibitions that concern behaviour in the spot market and through wholesale energy contracting, involving sophisticated private businesses that are in a position to protect their own interests.

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13 Amended through the *Competition and Consumer Amendment (Misuse of Market Power) Act 2017* (Cth).

14 Consultation Paper, pp. 5-6.

Infringement notices

An infringement notice regime can be effective for dealing with provisions where there is a clear bright line between what is lawful and unlawful, in circumstances where there is a sufficient need for deterrence and/or evidence that the threat of court proceedings is insufficient deterrence (eg because the costs of litigation exceed the benefit).

Civil penalties

It is proposed that the existing civil penalties will be available for the proposed prohibitions. The CCA civil penalty regime is one of, if not the, highest civil penalty regimes in Australian law. The maximum civil penalty is:

(a) for corporations – the greater of $10,000,000, 3 times the value of the benefits obtained from the prohibited conduct, or 10% of the annual turnover of the corporation; and

(b) for individuals – $500,000.

Given the serious nature of the civil penalties, it is important to ensure that the prohibited conduct is sufficiently clearly defined, and addresses the underlying harm to the public, to justify this level of penalties. As explained earlier in these submissions, we are concerned that this is not the case.

7. ENFORCEMENT – TREASURER'S POWER TO SET A PRICE CAP

7.1 Background

In this remedy, the ACCC may, once it has identified misconduct, recommend to the Treasurer that the Treasurer order that an energy company may only make retail offers at the default market offer price for a specified period.[15]

The Treasurer's determination would be subject to merits and judicial review.

7.2 Power to legislate

The Commonwealth's power to legislate depends on the *Australian Constitution* (**Constitution**). To have constitutional validity, legislation or an act of executive power by a Minister or agency must meet two requirements: there must be a positive source of power to enact the legislation or do the act, and there must not be any other limitations preventing the enactment of the legislation or doing of the act.

Section 51(xx) of the Constitution provides that the Australian Parliament may make laws with respect to foreign corporations, and trading or financial corporations incorporated in Australia. The Commonwealth primarily relies on this power to legislate the conduct of corporations under the CCA.[16]

Although the precise boundaries of this source of power may be debated, the High Court has treated this section broadly to encompass most laws directed at corporations. In

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15 Consultation Paper, p. 6.

16 The States and Territories have also enacted *Competition Policy Reform* legislation which applies Part IV of the CCA as State and Territory laws, regulating the conduct of "persons" rather than corporations. Changes to Part IV of the CCA are automatically incorporated into State and Territory law after two months passes from their enactment, unless a State or Territory government disallows the incorporation.

particular, a majority of the High Court in the *WorkChoices Case* (2006) 229 CLR 1 at [178] accepted the following statement:

> ... the power conferred by s 51(xx) of the Constitution extends to the regulation of the activities, functions, relationships and the business of a corporation described in that sub-section, the creation of rights, and privileges belonging to such a corporation, the imposition of obligations on it and, in respect of those matters, to the regulation of the conduct of those through whom it acts, its employees and shareholders and, also, the regulation of those whose conduct is or is capable of affecting its activities, functions, relationships or business.[17]

The power to legislate for the prices that a corporation sets in carrying on its business likely arises from the power under section 51(xx) to regulate the activities, relationships and business of corporations, and to impose obligations upon corporations.

There is precedent both within the CCA, and outside it, for the Commonwealth to regulate prices. These include:

(a) sections 95X and 95Y of the *Competition and Consumer Act 2010* (Cth) (**CCA**), which allow the ACCC to monitor and approve price increases for certain notified goods and services; and[18]

(b) Part IIIA establishes a negotiate arbitrate regime for declared services. In the event of an access dispute in relation to declared services, the ACCC has the power to arbitrate the outcome, including price.[19]

However, it is unusual for the Treasurer to exercise what is essentially a punitive power—that is, a retailer has breached the law and so should not be allowed to charge higher than the default offer (even if it would otherwise be permitted to do so), as opposed to making public interest decisions.

There is a constitutional prohibition on persons who are not judges of courts exercising judicial power. However, the concept of judicial power is difficult to define. In essence, it is the power to authoritatively decide disputes between parties about the existence of their rights and liabilities.[20] With some exceptions, a judicial power decides the existence of, and gives effect to, rights and liabilities which pre-exist the exercise of the power; the exercise does not create new rights or liabilities.[21]

In general terms, a power is not likely to be judicial if (in this case):

(c) the Treasurer decides whether to exercise it by reference to policy considerations that are unsuitable for a court to decide; for example, the national interest or the public interest;[22]

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17 *Re Pacific Coal* (2000) 203 CLR 346 (Gaudron J).

18 These provisions do not only rely upon section 51(xx) of the Constitution for validity; for example, they currently apply to Australia Post's postal services, and in this respect may rely on the Commonwealth's legislative power to regulate postal services under section 51(v) of the Constitution.

19 See section 44V of the CCA.

20 *Huddart, Parker & Co Ltd v Moorehead* (1909) 8 CLR 300, 357 (Griffith CJ); *Momcilovic v The Queen* (2011) 245 CLR 1, 64 (French CJ).

21 *Precision Data Holdings v Wills* (1991) 173 CLR 167, 191; compare *Thomas v Mowbray* (2007) 233 CLR 307, 328 (Gleeson CJ.

22 See section 69 of the *Foreign Acquisitions and Takeovers Act 1975* (**FAT Act**) and *Visnic v ASIC* (2007) 231 CLR 381, 386.

(d) the Treasurer's decision cannot be characterised as a remedy for, or enforcement of, breaches of provisions of energy laws;[23] and

(e) the Treasurer's decision is open to challenge in judicial proceedings.[24]

On the other hand, if the power requires the Treasurer to consider whether an energy company has breached existing energy laws, and the remedy the Treasurer orders is fairly seen as the consequence of such a breach, then the power is more likely to be judicial.

Deciding whether a power is judicial power depends upon a close analysis of all the circumstances of its exercise, and this is a matter that will require further careful consideration before the law is implemented.

However, whether or not the power is constitutional, we are concerned that, by giving the Treasurer this power, it will place the Treasurer in a position where he or she must effectively exercise judicial power, exposing the process to criticism that it might be exercised in a political manner, particularly decisions *not* to exercise the power.

There are therefore very good reasons to be circumspect before imposing such a requirement, and placing it in the hands of an independent judicial body, and not a person who holds both an executive and legislative position.

8. ENFORCEMENT – TREASURER'S POWER TO ORDER THE OFFER OF CONTRACTS

8.1 Background

In this remedy, the ACCC may, once it has identified misconduct, recommend to the Treasurer that the Treasurer order that the energy company offer generation capacity through contracts with unrelated parties (the **Contracting Order**).

The Treasurer's determination would be subject to merits and judicial review.

8.2 Power to legislate and precedent

The Contracting Order is relatively unusual, but not entirely without precedent: other regulators have powers to order corporations to make contractual offers. For example, under section 13E of the *Banking Act 1959*, the Australian Prudential Regulation Authority may order certain ADIs to increase their levels of capital.

We are concerned about the unbounded nature of the proposal, but recognise that the Consultation Paper calls for submissions on this issue. In order for this power to be exercised appropriately, it will be essential to set out clear criteria for exercising it. We consider that there is a material risk that, used inappropriately, the power could cause significant detriment particularly to the extent that the obligation to contract:

(a) denies a vertically-integrated firm from having sufficient wholesale energy contracting arrangements for its own operations; or

(b) requires the firm to contract on terms that are not commercial, having regard to the broader economic cycle—wholesale energy prices fluctuate over time, so requiring a firm to contract in a particular time period may damage the firm's ability

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23 *Attorney-General (Cth) v Alinta* (2008) 233 CLR 542, 578 (Hayne J) (***Alinta***).

24 *Alinta* at 578 (Hayne J).

to compete if they cannot make contracting decisions that take account of the economic cycle, including their own views about it.

We are also concerned that placing this power in the hands of the Treasurer, instead of a court or independent executive agency, may not be appropriate, particularly to the extent to which this might be characterised as a judicial power (in the sense that it is a remedy for a breach of law, as discussed in section 7.2 above).

9. ENFORCEMENT – TREASURER'S POWER TO ORDER DIVESTITURE OF ASSETS

9.1 Background

In this remedy, the ACCC may, once it has identified misconduct, recommend to the Treasurer that the Treasurer order that the energy company divest some or all of its assets (a **Divestiture Order**).[25]

The Consultation Paper contemplates that this would only occur if other remedies were insufficient to address the conduct and the public benefit of the order outweighed any public detriment.

The Treasurer's determination would be subject to merits and judicial review.

9.2 Power to legislate and precedent

The power to make a Divestiture Order is an extraordinary and invasive power. In the context of these reforms, it gives the Treasurer the power to punish a business that the ACCC considers has (but has not proven to have) breached the law by requiring it to divest assets.

The divestiture may fundamentally change the structure of that business, and the process of forced divestiture may result in a situation where the energy company is not fully compensated for the value of the divested asset, as the price achieved on a forced divestiture may not reflect market value, or the value of the asset to the energy company.

It is particularly concerning that a power with such a significant impact on an energy company could be exercised in circumstances where it would, in effect, operate as a form of punishment for *alleged* wrongdoing. In contrast with other divestiture powers (as discussed below), it does not operate to unwind a transaction that might otherwise have been illegal, but instead gives the Treasurer the power to intervene and change the business affairs of a private energy company, on the basis of allegations made by the ACCC which have not been proven in a court. In our view, the need for the Treasurer to have this ability, in such circumstances, has not been established and was not sought by the ACCC in the Inquiry Report.

Constitutional validity

The legal validity of the Treasurer having the power to make a Divestiture Order depends upon there being constitutionally valid legislation delegating that power.

The positive source of the Commonwealth Parliament's power to allow the Treasurer to order divestiture likely comes from section 51(xx) of the Constitution. In particular, the power of the Commonwealth Parliament to impose obligations upon corporations may extend to imposing an obligation to divest certain assets.

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25 Consultation Paper, p. 6.

There is also precedent for the Treasurer having a power of divestiture. Section 69 of the FAT Act gives the Treasurer the power to order a person who has acquired certain interests in Australian businesses/entities/land to dispose of those interests, if the acquisition is contrary to the national interest.

This section is not perfectly analogous to the proposed power of the Treasurer in respect of the Divestiture Order. In particular, section 69 operates to restore a status quo before an interest was acquired (see section 69(4)(a) of the FAT Act); the Divestiture Order is not limited in this way.

However, there are similarities between section 69 and the Divestiture Order. The power to order divestiture is vested in the Treasurer, not a court (compare section 81 of the CCA, which empowers a court to order a party that has acquired assets in breach of the CCA to dispose of those interests). The power to order divestiture is also not necessarily enlivened only when a breach of a law is proven; this is true of section 69, and may be true of the Divestiture Order, although it is unclear as it is intended to "crack down on poor market practices".

The Federal Court has upheld a predecessor of section 69 of the FAT Act as a valid provision enacted using the power under section 51(xx) of the Constitution.[26]

As discussed in section 7.2, the use of this power as a punitive remedy raises a question as to whether this is truly a judicial power, which should only be exercised by a court. This is particularly the case given the gravity of the power—a decision to require a private energy company to change its business structure should only be exercisable in circumstances where there has been clear proven misconduct which requires such a serious punishment.

The Divestiture Order also raises a further constitutional issue: the requirement in section 51(xxxi) of the Constitution that an acquisition of property for a purpose of the Commonwealth be on just terms. As we have noted, there are precedents for divestiture orders in Commonwealth legislation. There is also some case law to suggest that requirements to divest assets, particularly to third parties (not the Commonwealth), may not be subject to the requirement of section 51(xxxi).

However, it is important to recognise that a Divestiture Order may result in a situation where an energy company is required to sell assets through a process that may not necessarily appropriately compensate it for the value of the assets, as buyers will know that it is part of a forced divestiture process where the energy company's power to cancel the sale, or change the process, is limited and where wrongdoing has been alleged by the ACCC, but not proven.

This matter will require further detailed consideration.[27]

If the Treasurer is given the power to make a Divestiture Order, it will be essential to provide objective criteria setting out when and how that power is to be exercised, so as to make the merits and judicial review protections meaningful. In our view, there is considerable risk that without (and even with) clear and objective criteria about when and how this power will be used, the presence of this power will chill investment in the

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26 *Wight v Pearce* (2007) 157 FCR 485, 495.

27 *Mutual Pools & Staff Pty Ltd v The Commonwealth* (1994) 179 CLR 155 at 187 (Deane and Gaudron JJ); *Re Director of Public Prosecutions (Cth) Ex parte Lawler* (1994) 179 CLR 270, 285 (Deane and Gaudron JJ); *WSGAL Pty Ltd v TPC* (1994) 51 FCR 115.

Australian energy sector. This is because even with clear criteria, we consider that a forced divestiture is likely to:

(a) change, potentially fundamentally, the structure of the business subject to the Divestiture Order;

(b) involve a sale process that may not be suited to achieving sound commercial outcomes; and

(c) may result in commercial damage to the business that is not compensated through the divestment process—for example, a vertically-integrated business may place a higher value on integrated assets than buyers who acquire the business through a forced divestiture.

It is also relevant to bear in mind that the Australian Government operates significant businesses in the energy industry, and therefore may have an interest in acquiring divested assets itself. The possibility of that outcome is a further reason for separating any divestment decision from the executive, to the judicial, arms of Government.

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