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Guidelines on the Prohibiting Energy Market Misconduct Act – Draft Guidelines

The Australian Energy Council (the AEC) welcomes the opportunity to make a submission to the Australian Competition and Consumer Commission (the ACCC) regarding the Draft Guidelines on the Prohibiting Energy Market Misconduct (PEMM) Act (the Draft Guidelines).

The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEC welcomes the ACCC's comprehensive approach to developing these Draft Guidelines. The PEMM Act represents an unprecedented incursion into the operation of merchant businesses, and electricity businesses were justifiably concerned that the lack of clarity in the PEMM Act would create significant unintended consequences. To the extent possible, the Draft Guidelines go some way to mitigating these concerns.

However, the AEC considers that further guidance would be valuable in a number of key areas. In our submission to the ACCC's consultation paper in January, we noted that the PEMM Act lacked clarity, and would likely result in undesirable outcomes. In that submission we encouraged the ACCC to consider developing a number of high level principles that would enable electricity businesses to have a greater ability to understand the ACCC's interpretation of the new Laws in instances outside the examples presented in the Draft Guidelines. These principles would have also enabled the Guidelines to be more future proof, noting the multiple reforms and evolutions underway in the electricity markets at this time. It is the AEC's view that these principles remain critical in giving electricity businesses the certainty they need to be able to operate within an uncertain framework.

Whilst we understand the ACCC has intentionally left some terms open to interpretation, we consider that further clarity through a set of principles would enable electricity businesses to better train their operational staff as to what is expected of each provision, without reliance on the courts to determine the meaning of particular phrases.

S153E: Retail Pricing Provision

Primarily, the AEC is seeking greater clarity from the ACCC as to how it will enforce compliance in scenarios that are an extension of the examples provided. Whilst the examples provided are useful to identify clear instances of compliance or non-compliance, there are many practical scenarios that appear to be reasonable business practices to which the ACCC has remained silent. The AEC understands that the ACCC is limited when developing compliance guidelines to only refer to material that is reflective of the PEMM Act and the Explanatory Memorandum. That being said, this limitation creates significant risks for electricity businesses seeking to make decisions in line with standard practice, but outside the scope of the PEMM Act.

Small Customers

The AEC agrees with the ACCC's interpretation of this concept, however considers that greater clarity of the scenario presented in *Example 2* is necessary to reflect the requirements in the National Energy Retail Law (NERL). Example 2 appears to assume that a group of customers will be on one offer, and their prices will change consistently. In the scenario described, Retailer A has one set of offers which classifies small business customers as those who consumes less than 160MWh per year. The example assumes that all future offers will continue to reflect this classification. That assumption is not necessarily reflective of the retail regulatory framework. The NERL does not consider that customers are grouped for the purpose of price changes, but rather, requires retailers to notify customers individually of changes to their pricing in line with their market contract terms and conditions. Given this, simply because a retailer has customers consuming over 100MWh per annum on a particular offer, does not mean that all future prices that customer pays need to be reflective of the prices paid by other customers on that offer.

Case study 1:

On 1 January 2020, Retailer A introduces a new market offer, eligible to any Small Business customer consuming less than 160MWh per annum. Over the next 6 months, there is a sustained and substantial reduction in the cost of procuring electricity. On 1 July 2020, the retailer proposes to reduce its prices. In line with Rule 46 of the National Energy Retail Rules (NERR), Retailer A notifies all customers who consume less than 100MWh of a reduction in the price of their tariffs. Retailer A does not notify customers consuming more than 100MWh of a tariff variation. Retailer A has not breached section 153E.

Underlying cost of procuring electricity

The AEC considers that further clarity on environmental cost reductions in the Guidelines would be beneficial. Retailers currently diversify their procurement of environmental certificates through a number of avenues. As such, they might have entered into a power purchase agreement with a solar farm some years ago, purchased other certificates on the spot market to cover a shortfall, or obtained certificates in some other manner. Given this diversity, the AEC expects that the ACCC will take a holistic approach when considering if reductions in the spot market for certificates, for example, indicate a substantial and sustained reduction in a retailers environmental costs.

For clarity, the AEC encourages the ACCC to include an example to this effect, highlighting that in line with the treatment of wholesale costs, if a retailer is unable to pass through a market wide cost reduction in environmental costs due to their particular circumstances, then this would not breach section 153E.

The AEC further considers that an exhaustive list of environmental schemes would be beneficial to be included in the Guidelines.

Sustained and substantial reductions

The AEC considers that this concept is critical to enabling electricity businesses to appropriately develop processes and procedures that will ensure compliance. Whilst the ACCC notes that it is unable to set a threshold in determining whether a reduction is sustained and substantial, the AEC are comfortable that the examples suggested in the Draft Guidelines are reflective of how electricity businesses currently identify cost reductions in today's market.

The AEC do believe that it would be helpful for the ACCC to explicitly recognise that there are a wide variety of ways retailers practically hedge, and a wide variety of ways in which both standalone retailers and vertically integrated retailers consider and account for their wholesale energy cost, and the changes in wholesale energy cost. A 'one size fits all' approach to quantifying the change in wholesale costs will not be achievable.

We welcome clarity provided in the Draft Guidelines that normal fluctuations in wholesale costs are not considered representative of a long-term trend.¹ However, the AEC does consider the ACCC to have an important role in educating the sector about its compliance obligations. Accordingly, to the extent that the ACCC has observed an eligible reduction in market or sector-wide costs, it would be helpful if the ACCC were able to alert relevant players in the industry of the reduction and its expectations, at least in the early implementation phase, as retailers align their pricing processes to the new laws.

Reasonable adjustments

The ACCC's interpretation of reasonable adjustments is of greatest concern to the AEC. Whilst we accept that 'reasonable' as a term is not defined in the PEMM Act and will require case law to appropriately develop its meaning, the AEC do not consider the Draft Guidelines provide enough clarity to electricity businesses on what might be considered a reasonable adjustment, and will make it difficult for electricity businesses to ensure compliance. This lack of clarity can only increase costs for electricity businesses, as they attempt to err on the side of caution. As has been noted previously, the AEC is concerned that overly frequent price adjustments will decrease the customer experience (a risk also acknowledged in the EM).

Out of cycle price changes

The EM highlighted that retailers were not expected to make reasonable adjustments to their prices immediately if that retailers next planned price adjustment was forthcoming. Paragraph 2.40 of the EM in particular makes clear that retailers are not expected to make many changes to retail prices throughout a year. The AEC supports a notional limitation of one price adjustment per year, in all but the most extreme scenarios.

The Draft Guidelines suggest that if a retailer's next regular price reset process is not commencing soon, it might be reasonable to expect the retailer to make a specific price adjustment to reflect this new cost decrease.² Example 8 then goes on to suggest that a scheduled price reset 3 months away would be a timeframe that would not require a retailer to make an out of cycle adjustment. Paragraph 2.25, in combination with Example 8, does not appear to be in line with the EM, which appears to suggest that out of cycle price changes would be the exception, rather than the norm³.

¹ Paragraph 2.19

² Paragraph 2.25

³ Paragraph 2.40 of the EM states "It would not be reasonable, for example, for a retailer to fail to take into account a sustained and substantial reduction in its supply chain costs the next time it changes its retail prices."

Example 10 exacerbates this lack of clarity. In this scenario, a customer has entered into a 12 month fixed price contract with Retailer A. In the event of a price reduction, this 12 month contract does not appear to need to immediately pass through reasonable adjustments, however the ACCC notes that for a longer fixed price contract, the retailer may need to adjust the price within the term of the contract. The AEC does not consider this example provides adequate guidance to electricity businesses. This uncertainty could have the unintended effect of retailers ceasing to offer fixed price contracts, a product that offers customers additional certainty in relation to their energy prices.

The AEC considers that the ACCC should also provide greater guidance to electricity businesses as to what it considers a reasonable timeframe to make adjustments for small customers. As noted in the AEC's submission to the ACCC's previous consultation on these Guidelines, a principles based approach would provide clarity to retailers, while still delivering on the intent of the PEMM Act. In practice, this would mean that the vast majority of reasonable adjustments should be expected to be made at the retailer's next planned price reset. Only the most extreme scenarios should require an out of cycle reset, with a higher threshold set out for fixed price offers as described in example 10.

Reasonable adjustments for different retail products

The AEC considers the second critical element of this concept relates to reasonable adjustments for different retail products, or more accurately, for different retail customers. While the PEMM Act does not itself differentiate between retail products, the EM does provide some guidance as to its intended application for customers on products with differing margins. Example 14 of the Draft Guidelines is reflective of example 2.6 in the EM. Whilst these examples expressly limit different outcomes to different retailers, the AEC considers a more competitively neutral interpretation would be to consider the type of offer or product, rather than the type of retailer making that offer.

For example, as was identified in the ACCC's Retail Electricity Pricing Inquiry, the prices paid by customers do not only vary *between retailers*, but can also vary significantly *within retailers*. This therefore creates a scenario where some customers are more profitable to their retailer than others. The Draft Guidelines appears to suggest that all customers, on all offers should receive equivalent reasonable adjustments.⁴ This scenario appears incongruent with a competitive retail market where customers are encouraged to engage to seek out a cheaper deal.

While Example 12 makes clear that a retailer would not be able to only pass through a price reduction to a group of engaged customers on a lower offer, we consider that greater clarity is required in the inverse scenario. A retailer should be able to reduce its prices on higher priced offers to which it is profitable, but not required to reduce its prices on lower priced offers to which it is not. In effect, these lower priced offers might already be reflective of an expected future cost decrease. Without this clarity, retailers will be discouraged from offering lower cost energy products throughout the year, which may have the unintended consequence of decreasing competition in the retail market. Requiring retailers to reduce all products at the same rate would likely make some products unsustainable, and entrench inequity between customer groups.

To resolve this concern, the AEC considers that an additional example should be developed, highlighting that the intended equivalent reduction in price applies to like customers, at similar base pricing, rather than like customers on any base price as described in paragraph 2.26.

It would also be helpful for the ACCC to confirm that it would be reasonable for a retailer to make an adjustment through some other form of discount or credit, provided that all relevant customers are guaranteed to receive the adjustment for the duration of the reduction. At the same time, many retail

⁴ Paragraph 2.26

customers will switch to lower priced contracts between annual price resets, in effect taking up a contract that might already have had any reduced costs factored into it. The AEC does not expect a retailer would be expected to reduce the prices for customers who are already receiving the benefits of the cost reduction in this manner.

Transitional requirements

The AEC is concerned about the ACCC's intent to take into account cost reductions experienced by retailers prior to the commencement of the PEMM Act. This creates significant uncertainty for retailers, particularly given the spread of offers currently available in the market (often from contracts entered into prior to the PEMM Act even passing Parliament).

The AEC considers that the transitional considerations in paragraph 2.42 should be removed, or clear guidance be provided to retailers as to the extent and scope any prior year reductions should be treated by retailers. This would include the number of months retailers are expected to consider prior to commencement of the PEMM Act, the scale of reductions, and the extent to which reductions must be passed through to individual customers on differing prices.

Section 153F – Electricity Financial Contract Liquidity Provision

Broadly, the AEC agrees with the ACCC's interpretation of section 153F of the PEMM Act. Most importantly, we welcome the efforts of the ACCC to highlight the many legitimate scenarios in which an electricity business may not offer electricity financial contracts.

However, we believe that further guidance is needed in relation to the ACCC's interpretation of electricity financial contracts. The Guidelines helpfully confirm at paragraph 3.5 that these do not include contracts for the supply of electricity (or physical contracts). Some physical contracts nevertheless settle by reference to the spot price. It is our interpretation that these should not be captured by this prohibition – even though it may technically be caught by the definition in the PEMM Act.

Further, the AEC considers it would be beneficial to define financial contracts as those that meet the standard definitions in the contracts typically traded by the industry as promulgated by the International Swaps and Derivatives Association (ISDA), and should only apply to negotiations between generators and retailers. Leaving the definition open creates onerous obligations on electricity businesses required to consider every contract entered into in light of this provision, rather than focusing on ensuring compliance for the ACCC's intended enforcement priorities.

Section 153 G & H – Electricity Spot Market Provisions

The AEC consider that it is necessary for the ACCC to provide greater clarity between how the National Electricity Rules (NER) will interact with the PEMM Act, in instances where slightly differing conduct is required. In particular, the ACCC should make clear in the Guidelines that an electricity business who acts in accordance with the market design principles of the NEM will not be considered to have distorted or manipulated prices.

For example, in *Example 28*, Generator A is noted as providing bids 'well in advance of the peak period' as required by the NER. The requirement in the NER is to provide bids as soon as practical after the change in strategy occurs. The AEC encourages the ACCC to amend example 28 to include wording reflective of the electricity businesses existing obligations.

More broadly, the AEC considers it would be valuable for the ACCC to provide greater guidance as to how they intend to enforce the electricity spot market provisions given that the Australian Energy Regulator also has an enforcement role for the similar provisions in the NER. The AEC's preference is for the AER to enforce the energy laws in the majority of instances, with the ACCC only seeking to take action in circumstances where the conduct of the electricity business is of the kind intended to be captured by the expanded prohibitions in the PEMM Act.

ACCC investigation and enforcement

The AEC is broadly supportive of the ACCC's intended approach to investigation and enforcement of the PEMM Act. However, the AEC is concerned about the impacts of COVID-19, and the resulting risks of non-compliance facing electricity businesses.

As the ACCC is aware, electricity businesses are facing unprecedented challenges as essential service providers during this time. In circumstances where corporate facilities have been closed both in Australia and overseas, and safety and transmission mitigation practices have been heightened for staff unable to work from home, a new and onerous compliance obligation creates significant risks. In particular, the necessary training of staff in advance of the June 10 2020 commencement date will not be achievable in the current environment.

To this end, the AEC would welcome the ACCC taking a more educative approach upon commencement of the PEMM Act given the impacts of COVID-19. Whilst the AEC understand the ACCC does not have the powers to delay commencement unilaterally, a more collaborative approach can only be beneficial at this time.

The AEC supports the ACCC's proposed approach to recommending contracting and divestiture orders in paragraph 6.27 of the Draft Guidelines. These penalties are extraordinary, and as such a high threshold is critical to provide confidence to electricity businesses that the powers will not be recommended arbitrarily. Further the AEC considers that clarity that the ACCC intends to take a graduated response to enforcement, in all but the most egregious circumstances.

The AEC also agree with the ACCC's view in paragraph 1.6 that the conduct prohibited in the PEMM Act is focused on the operation of the NEM, and as such, is not directly transferrable to the markets in Western Australia and the Northern Territory. If the ACCC intends to change its enforcement approach in future, the AEC considers that a reasonable notice period will be required.

For any questions about our submission please contact Ben Barnes, General Manager, Retail Policy by email at ben.barnes@energycouncil.com.au or on (03) 9205 3115.

Yours sincerely,



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