AUSTRALIAN ENERGY COUNCIL

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Guidelines on the Prohibiting Energy Market Misconduct Act – Issues for consultation

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

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 has engaged closely with the Government and other key stakeholders on the PEMM Act for more than 12 months. Whilst the PEMM Bill that recently passed the Parliament included some minor amendments from the iteration introduced in December 2018, the AEC remain concerned that the PEMM Act lacks the clarity required to enable energy businesses to be confident in its application.

This lack of clarity increases the importance of these Guidelines. The Senate Economics Committee (the Committee) in its *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 [Provisions]* Inquiry noted that the definitions and operation of the legislation, largely without precedent in the energy laws or the Competition and Consumer Act (CCA), would need to be resolved by the ACCC in order to make its interpretation and enforcement approach clear[1]. As a starting point, the AEC encourages the ACCC to ensure that it interprets and enforces the PEMM Act in line with the revised explanatory memorandum (the EM).

The AEC is particularly interested in the ACCC's interpretation of the three new types of prohibited conduct the PEMM Act details. The Law Council of Australia, in its submission to the Committee noted that it did "not believe that the Bill in its current form is the best method of achieving the policy outcomes it is intending to achieve and may indeed have unintended undesirable consequences."[2] Given no changes were made to improve the PEMM Act's drafting since the Committee report was published, the ACCC has a challenging task ahead of it in developing these Guidelines.

Other aspects of the PEMM Act remain relevant, and the AEC is keen to better understand how the ACCC will undertake its obligation to interact with electricity businesses when undertaking investigations, the scope of

[1] Economics Legislation Committee, Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 [Provisions], Pg. 68
[2] Law Council of Australia, Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 [Provisions] Submission 16, Pg. 1

information that will be made public in its notices, and its approach to making prohibited conduct recommendations.

Principles of interpretation

Noting the lack of clarity that has been highlighted by multiple stakeholders throughout the development of the PEMM Act, the AEC encourages the ACCC to not only seek to define particular terms, but also to provide in the Guidelines a set of guiding principles that it considers would illustrate compliance with the intent of the PEMM Act. This is best achieved by giving meaning to the provisions of the PEMM Act by referencing the EM, which provides some context to otherwise highly uncertain provisions.

This would enable the ACCC to give effect to the intent of the PEMM Act, without increasing the risk of unintended consequences. We are keen to see a more principles-based style of regulation, where the Guidelines sets out a number of key regulatory principles that the ACCC will consider and apply when taking action under the PEMM Act. The AEC also believes the use of more complex examples to demonstrate the application of these principles would be essential to fully understanding the ACCC's intended approach. This submission provides a number of suggested examples highlighting conduct that should be considered compliant when interpreting the PEMM Act.

Part 1: Prohibited Conduct in the electricity industry

Retail prohibited conduct (s153E)

At a high level, section 153E requires retailers to pass on reductions in wholesale electricity costs to consumers. It is intended to ensure that small customers share the benefit of falling procurement costs.[3] It is not intended to discourage investment, nor is it intended to result in more frequent price changes to the detriment of customer experience.

The PEMM Act itself requires retailers to make reasonable adjustments to reflect sustained and substantial reductions in *its* underlying costs of procuring electricity. The EM however describes the costs of procuring electricity as *market wide* costs. This creates ambiguity in how the provisions will be applied. Yet, both these concepts are important, as it enables a retailer to recover the cost of risk in procuring electricity, incentivising innovation and investment, and to have regard to all the surrounding circumstances of a retailer's cost position.

The AEC considers that example 2.8 in the EM is illustrative of this concept, and should be made clear in the Guideline.

> **Proposed guiding principle**:
>
> The ACCC will not take enforcement action unless a retailer has *unreasonably* failed to pass through *market wide* reductions in electricity procurement costs to its customer base *over time*.

As highlighted in the EM, a retailer is not required to pass through market wide reductions in procurement costs if in fact their own procurement costs did not reduce. Similarly, it would not be required to pass through reductions in costs already accounted for in setting the price.

The Guidelines should also clarify that the retailer's circumstances include both current costs and longer term costs to ensure risk and pricing strategies are taken into account.

[3] EM, paragraphs 2.15 and 2.19.

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We expect the calculation of the Default Market Offer (DMO) will be informative to the ACCC's assessment of procurement costs, but not determinative. The DMO assessment is based on predicting costs, for an efficient retailer in a future period, rather than retrospectively calculating the costs incurred by retailers' over the preceding year. For this reason, the AEC recommends that the ACCC makes clear in the Guidelines that a reduction in the DMO will not necessarily require an equal reduction in market offer prices. This is also acknowledged in the EM, which sets out a number of examples of when it would be appropriate for a retailer not to amend its pricing. The ACCC should consider including these examples, or otherwise expanding on these examples, in the Guideline. For example, the Guidelines could include an example similar to the following:

> **CASE STUDY 1: DMO reduces by 10%, retailer reduces market offers by 7%**
>
> For the 2019/20 financial year, the AER determines the DMO for an average customer in the Ausgrid network should equate to $1000. Ahead of the 2020/21 financial year, the AER predict that input costs will fall in the coming year, so proposes to reduce the DMO to $900. *Energy Us* is an energy retailer as defined in s153E(1)(a). After considering their expected costs of procuring electricity for the 2020/21 financial year, and taking into account an expected increase in their operating costs caused by the implementation of a new billing system, *Energy Us* determines that they will decrease their prices by an average of 7%. Energy Us has not breached s153E(1)(b).

As highlighted in the EM example 2.7, a retailer is not expected to pass through market wide cost reductions from which it does not, or is unable to benefit. The AEC considers the following example would provide greater clarity to participants:

> **CASE STUDY 2: Spot fuel prices fall but gentailer is locked into long-term arrangements**
>
> *Energy Us* is a vertically integrated retailer with gas-fired generation as a major part of its supply. It has entered into long-term gas contracts at an average price of $9 per gigajoule which reflected spot prices at the time of entering into the contracts. Recent changes in the gas market have led to spot prices moving down to around $6 per gigajoule. As *Energy Us* cannot benefit from the fall in price, they are not obliged to pass through this change to its retail customers. Energy Us has not breached s153E(1)(b) in these circumstances.

Similarly, the term "*over time"* ensures that market wide reductions are passed through to customers, but clarifies that there is no expectation that the price reduction will occur immediately, nor at the expense of positive customer experiences. As noted above, the intent of s153E is to ensure that customers obtained the benefits of reducing prices[4], not to require more volatile customer pricing. The EM notes this point when discussing what will be considered 'reasonable adjustments' to prices, including the fact that adjusting prices can lead to a lack of understanding or uncertainty for consumers as well as for retailers.[5] The Guidelines need to reflect the fact that adjustments to prices are intended to be for the benefit of consumers, and that consumer detriment is a broader concept than just higher pricing. This concept is illustrated in the below example:

> **CASE STUDY 3: Shortly after price change, wholesale costs reduce dramatically**
>
> *Energy Us* is an energy retailer as defined in s153E(1)(a). On 1 July 2020, *Energy Us* decreases their prices to account for its expected costs of procuring electricity in the coming 12 months. In order to ensure positive customer experiences, they have an internal commitment to only change their prices

[4] In particular, the EM (paragraph 2.15) notes that the purpose of section 153E is "to ensure consumers see the benefit of supply chain cost savings, and that such savings are not retained by retailers to the detriment of their consumers."
[5] EM, paragraph 2.34.

once per year. From 1 August to 1 October 2020, a sustained and substantial reduction in the market wide costs of procuring electricity is identified. The retailer's circumstances mean that this reduction will also lead to a reduction in its costs of procuring electricity. On 1 July 2021, *Energy Us* again reduces their prices, taking into account the greater than anticipated cost decline of its FY 2020/21 procurement costs. *Energy Us* has not breached s153E(1)(b).

The ACCC should also ensure that its interpretation of this clause does not impede the ability of retailers to offer beneficial energy products in the competitive energy market, nor should it require all reductions to be passed through to all customers equally at all times. Retailers all offer differing energy products, to align to their customer strategy at a particular point in time, including:

- Retailers seeking to grow their customer base might offer attractive products for a short period to new customers, without reducing their prices for existing customers.

- Retailers seeking to provide innovative arrangements with small customers, for example developing Virtual Power Plants (VPP) through the aggregation of customers' controllable appliances and batteries.

It is important that the ACCC does not discourage retailers from differentiating their offers, nor should it implicitly require retailers to minimise price dispersion. Dispersion is key to both physical innovation and competitive entry. The concept that customers should be able to benefit from engagement with a retailer must continue to be encouraged.

CASE STUDY 4: Price reductions do not need to be evenly weighted amongst customers

Energy Us is an energy retailer as defined in s153E(1)(a). Following a 15% decrease in market wide procurement costs in FY2019/20, *Energy Us* decides to reduce its customer pricing for FY2020/21. In FY2019/20, Group A paid 15c/kWh, Group B paid 20c/kWh, while Group C paid 19c/kWh on a 12 month fixed rate plan. *Energy Us* considers it is fairest if Group B customers receive a 7% price reduction, while Group A customers receive a 2% price reduction. *Energy Us* reduces the price for Group C customers when they each roll off their fixed rate benefit period. *Energy Us* has not breached s153E(1)(b).

The ACCC must not consider whether or not specific instances of conduct of the retailer is captured by the PEMM Act individually, but rather, should consider whether the conduct of the electricity business overall is in line with the intent of the PEMM Act broadly. This is particularly necessary for the term 'reasonable adjustments', which cannot be characterised in a manner where an individual input cost reduction results in a correlating price reduction for consumers.

At the same time, a retailer should be free to determine what form a reasonable adjustment will take. For example, whether the adjustment is made to the underlying tariff, is made by way of an increase to a discount applied to the price, is applied as a one off credit, or through some other customer benefit.

The Guidelines should also make clear that retailers are not expected to pass through cost reductions where a retailer and customer have agreed to enter into a fixed price contract.

The AEC also notes that the PEMM Act only specifically excludes standing offer prices regulated by the Electricity Industry Code. The ACCC should clarify in its Guidelines that it will similarly not take action against a retailer in Victoria for failing to reduce its VDO in circumstances that would otherwise lead to a price reduction being passed through. The AEC also expects that the ACCC make clear that where contradictory obligations arise in the electricity laws, retailers cannot be found to have breached this obligation (for

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example, the ESC in Victoria is proposing to prohibit price changes unless they occur on the VDO change date).

Given the lack of clarity in the term 'sustained and substantial reductions', the AEC considers it would be beneficial for the ACCC to clarify its views on the following matters in the Guidelines:

- What period of time would the ACCC consider to be the minimum period to demonstrate a "sustained" reduction in prices?
- What type of reduction would the ACCC consider to be the starting point, in order to be considered "substantial"?
- In determining whether there has been a "sustained and substantial" reduction, the AEC seeks confirmation that the ACCC will take into account seasonality in wholesale electricity costs so that normal seasonal fluctuations in pricing are not considered to be representative of a long term price trend

Financial Contracts Prohibition (s153F)

Section 153F is aimed at ensuring generators, most likely gentailers, do not refuse to offer financial contracts for anti-competitive purposes. In effect, the EM notes that the prohibition is intended to ensure standalone retailers, reliant on the liquidity of the financial contract market, are able to adequately hedge their risk. [6]

The AEC considers it critical that the ACCC distinguishes in the Guidelines between the nameplate capacity of the generator, and the practical or operational limits in which it might be contracted. Nothing in this prohibition should be enforced in any way that cuts across plans for operating units, provided these plans are not undertaken for the purpose of substantially lessening competition. The Guidelines should also recognise that there are many legitimate reasons why a generator may not offer a contract and that as long as the generator is acting reasonably, there should not be any concerns raised under the PEMM Act.

The AEC submits that the Guidelines should also set out a clear suite of principles for generators when they are determining whether or not to offer contracts. In particular, the Guidelines should recognise that when determining whether or not to offer contracts in the form described in the PEMM Act, electricity businesses are entitled to consider a range of relevant factors, including at least: safe operating limits, age of plant, availability of fuel, risk limits, and counterparty credit quality and counterparty concentration. Similarly, demand side uncertainty, commercial and industrial plans, and volumetric constraints will also be legitimate relevant factors in determining whether or not a generator might choose to offer financial contracts.

After allowing for the many technical and business prudency concerns which reasonably constrain a willing generator's ability to sell contracts, it should also be recognised that contracting is not the only legitimate path to market for a dispatchable generator. Contracting ahead benefits a generator by smoothing spot market returns, but not to the point where it should accept unreasonably low returns. It is entirely legitimate for a generator to alternatively choose the spot market for its path to market when the contract market under-values its view of the future spot market. Indeed allocative efficiency can only be achieved when a supplier has the freedom to select the most valuable market into which to sell its product. The Guidelines should not influence a generator to contract to a greater level than is economically rational given the conditions at the time.

There is also the potential for counterparties to take advantage of this prohibition in an attempt to apply pressure to a generator to offer uncommercial contracts or prices. The AEC considers that the ACCC should

[6] EM, paragraph 2.49.

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take into account all the surrounding circumstances when evaluating a generator's behaviour – there should be no expectation that a generator will offer contracts it does not reasonably consider to be commercially acceptable.

In addition the AEC seeks clarity on the application of s153F to Commercial and Industrial customers, who often enter into highly negotiated contracts with generators directly. The EM suggests that s153F is intended to apply to financial contracts between generators and retailers[7], rather than between generators and end users.

At the same time, the AEC suggests that the ACCC clarify that the relevant test for the inferred purpose provisions in section 153J is a subjective test of the purpose of the company engaging in the conduct. While objective circumstances might be relevant to establishing the company's subjective purpose, purpose requires a subjective assessment and this needs to be made clear in the Guidelines to ensure that section 153J is assessed in the same manner as the rest of the CCA.

Further, given that the impact of section 153J is that a company can be deemed to have a particular intention, the ACCC needs to provide additional guidance around how that intention will be determined. This is particularly important in relation to electricity markets and generators, given the significant operational and regulatory complexities which generators operate under due to the National Electricity Market (NEM) and other electricity market structures. At the very least, the Guidelines should require a consideration of safety and risk mechanisms that generators are either required to impose or have implemented in order to increase the security or redundancy of their generation capabilities.

In particular, the AEC considers that the Guidelines should make it clear that an anti-competitive purpose cannot be inferred to the extent that a generator has taken a certain action in order to: (a) increase its protections for the safety of its customers, employees, contractors and/or other third parties; (b) improve or streamline its back office services, or otherwise to comply with relevant accounting standards; (c) increase redundancies or the overall flexibility of its services for the purpose of ensuring consistent supply to its existing customers; or (d) protect itself financially given a customer or potential customer poses a credit risk to the generator.

In effect, the ACCC must not commence action against a generator simply because it fails to take a certain specified action, for example if it fails to offer contracts on its available capacity. The Guidelines should clearly reflect the fact that the ACCC will commence proceedings against a generator only when it takes the specified action, for the express purpose of substantially lessening competition in another market.

> **Proposed guiding principle**:
>
> *The ACCC will not commence action against a generator that fails to offer, or offers on unreasonable terms, any contract that breaches a generator's permissible risk policies, with regard to safety, age of plant, fuel availability, risk limits, counterparty credit quality and counterparty concentration.*

The current example considered in the EM (example 2.14) is simplistic and should be expanded upon in the Guidelines in order to provide generators with greater certainty regarding when the requisite purpose will be inferred. As noted above, generators are subject to a significant number of operational and regulatory constraints, many of which might impact on a generator's actions. The purpose of these actions could easily be inferred in the wrong manner if the generator's actions are not considered in the broader context of the NEM and other electricity market structures. The Guidelines should be drafted to ensure that this unique and complex context is always relevant to the ACCC's assessment of a generator's purpose.

[7] EM, paragraph 2.68

CASE STUDY 5: Generators prudently do not contract to the last MW

BigGen is a generator as defined in s153F(a)(i). *BigGen* owns a power station with four units. It fears that one unit will be unavailable due to a forced outage at a time of high prices which might expose it to large difference payments. Therefore it chooses to only contract to the hot weather capacity of three units. In these circumstances *BigGen* has not *failed* to offer electricity financial contracts against its fourth unit, because for prudent operational reasons it has chosen not to.

CASE STUDY 6: Generator Outage management

BigGen is a generator as defined in s153F(a)(i). *BigGen* owns a dispatchable generator. In the next 12 months it plans to undertake major maintenance at one of its units for an extended period. In the lead up to this planned outage, *BigGen* decreases the volume of financial contracts it usually sells to account for its expected decrease in generation. *BigGen* has not breached s153F.

CASE STUDY 7: Gentailers must allow for stochastic supply and demand

Energy Us is a generator as defined in s153F(a)(i). *Energy Us* holds a complex portfolio of different generation assets and retail customers, each of which is dependent on uncertain weather conditions and forced generator outages. There is therefore no deterministic maximum generation output nor maximum retail load. Instead *Energy Us* performs computer simulations of the stochastic nature of its portfolio to determine a probabilistic distribution of financial outcomes. Its risk management policy sets a maximum Value at Risk (VAR), for example "A 95% confidence of limiting spot market losses to $50m". Retailer A has sought a contract from *Energy Us* but the model calculates the sale would breach the VAR limit. In these circumstances *Energy Us* has not *failed* to offer electricity financial contracts, as it is not in a position to offer them.

CASE STUDY 8: Participants must consider counter-party credit risk

BigGen's financiers require it to operate with a conservative risk policy such that all counter-parties must hold investment grade credit ratings. *Energy Us* holds no such rating and *BigGen* is therefore unable to offer it electricity financial contracts. In these circumstances, *BigGen* has not breached s153F.

CASE STUDY 9: Counter-party concentration

Retailer *Energy Them* is in competition with gentailer *Energy Us'* retail business. *Energy Them's* credit rating satisfies *Energy Us'* risk policy and is sold a 50MW contract. Later, *Energy Us* posts an offer to sell a further 50MW. *Energy Them* seeks to take up this offer but is rejected as 100MW would breach *Energy Us*' risk policy for maximum counterparty concentration. *Energy Us* has not breached s153F.

CASE STUDY 10: Suppliers can sell into the market that values their product most highly

BigGen owns a dispatchable generator. It can find willing buyers of contracts but these are trading below its view of future spot prices. *BigGen* opts not to offer financial contracts on its available generation capacity, and instead opts to expose its generation to the spot market. *BigGen* has not breached s153F.

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Electricity Spot Market Prohibited Conduct (s153G and s153H)

Section 153G and 153H seek to prevent generators engaging in conduct which undermines the effective operation of the electricity spot market. The EM recognises the design of the NEM, and the role high prices play in signalling new investment.[8] However the wording of the PEMM Act does not specifically state that behaviour that is expected by the design of the NEM is not subject to the prohibition. As has been recognised in the EM, conduct of this nature is indeed necessary to underpin long-term customer reliability. Therefore the Guidelines need to make clear that such behaviour is not prohibited.

Features of the NEM's design that must be considered when developing these guidelines are:

- Electricity reliability is extremely valued, both by customers (as expressed by the Value of Customer Reliability[9]), by government, and the community in terms of public confidence.

- The NEM is an energy-only market design where generators only receive spot market revenue when they are operating, or through contract payments insuring against the risk of high spot prices. There is no explicit payment for reserve plant not operating but which are necessary to provide reliability during periods of extreme demand or plant breakdown.

- Whilst an energy-only market is consistent with markets in other goods, electricity is an essential service characterised by very low short-run demand elasticity. This means it is necessary for the integrity of the market to apply a market price cap which in turn distorts the ability to provide sufficient capacity revenue to meet reliability expectations.

- Some markets overcome these problems by providing either capacity payments to standby generators, or by including a regulated price "adder" to the spot price in low reserve conditions[10]. However the NEM anticipates that retailers will contract with sufficient generators to meet their own peak loads, thereby providing a decentralised form of capacity market. Contracted generators then tend to bid into the spot market near short-run-marginal-cost[11], having previously secured revenue to cover the capital cost of that capacity from contracts.

- The NEM design assumes that generators will bid in a way that has significant reference/reliance on their contracted position – they will bid to optimise the revenue available through spot and contracting arrangements.

- However, for such a market to work, the spot market must be potentially volatile, i.e. uncontracted retailers must see value in insuring against volatility, either through contracts or arranging to reduce their customers' demand. However the price cap limits this risk in a potentially problematic manner.

- It is expected that uncontracted capacity will bid into the spot market well above marginal cost – indeed it is expected that it may even "shadow" the price-cap by bidding near this level. The EM example 2.15 of a peaking plant waiting for price spikes before it bids capacity into the market is this expected behaviour – although in the NEM it is more likely to bid continuously near the price cap and wait to be dispatched and set price.

[8] Paragraph 8.88, EM.
[9] See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/values-of-customer-reliability-vcr
[10] See discussion of Texas Real-Time Reserve Price https://www.ferc.gov/CalendarFiles/20160629114652-3%20-%20FERC2016_Scarcity%20Pricing_ERCOT_Resmi%20Surendran.pdf
[11] Or in the case of a generator who has sold only cap contracts, it will tend to offer capacity near the cap strike price.

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- It should also be recognised that the value of firm capacity is the same regardless of whether it exists in a peaking or base-load plant[12]. The market design anticipates that a base-load plant with uncontracted capacity may also shadow the market price cap at times of peak demand, even if it bids close to marginal costs at other times to ensure efficient dispatch. This is presented in Case Study 11 below.

These features were thoroughly considered by the Australian Energy Market Commission (AEMC) in 2010 when rejecting a proposed rule change that would limit generators' ability to occasionally set high spot prices.[13] The Commission noted:

> *"Spot price volatility is an inherent and necessary feature of a market with the characteristics of the NEM. Flexibility is essential for maintaining a reliable system given the range of factors that impact on the dynamics of both demand and supply of electricity.*
>
> *The Commission notes, based on the findings of the analysis undertaken by Seed Advisory, that it is possible for users in all NEM jurisdictions to mitigate their financial exposure to price spikes through hedging strategies."*
>
> and
>
> *"A rule as proposed by the MEU* (the proponent)*, or similar, which seeks to limit occasional price spikes by capping generator dispatch offers is difficult to reconcile with the fundamental features of the NEM. A rule that limits the ability of generators to bid during particular periods in a manner that seeks to recover their efficient costs over time is likely to be detrimental to the NEM investment environment."*

CASE STUDY 11: Base-load generator bidding at high prices

BigGen has a 1,000MW base-load generator and has sold 400MW of contracts. For the majority of the year it bids the entire capacity into the NEM at its low marginal cost, and achieves high output levels. The uncontracted capacity achieves no return when it sets price at low demand, and a small return at times of moderate demand when, for example, contracted gas plant is setting slightly higher spot prices. Whilst the resulting dispatch is efficient, this spot income is insufficient to cover *BigGen's* fixed costs.

With a very high demand forecast tomorrow, it is apparent that *BigGen's* capacity will be required to supply it, implying some customer demand is uncontracted. For the period of the peak, *BigGen* changes its bidding strategy to that of a peak generator such that the uncontracted 600MW shadows the price cap, setting a very high price during that time. As required by the National Electricity Rules, this change in bidding strategy is telegraphed in advance through AEMO's rebidding and predispatch forecasting systems.

As the behaviour is expected by the market design, this would not be a contravention of 153G, 153H or 153J.

[12] A peaking plant means a dispatchable plant with relatively high marginal costs (e.g. liquid fuel) whilst a base-load means a dispatchable plant with low marginal costs (e.g. brown coal).
[13] https://www.aemc.gov.au/sites/default/files/content/b0feca33-0630-45e8-9bfc-54dfa262acd0/Final-Determination.PDF

It is imperative that the ACCC make clear that a generator acting in accordance with the design of the spot market cannot be found in breach of the PEMM Act. The AEC considers that the existing obligations in the National Electricity Rules adequately protect customers from inappropriate rebids. These obligations, amended in 2015,[14] represent clear guidance as to how the ACCC should interpret the boundaries of the PEMM Act. Duplicative regulatory obligations decrease efficiency in the market, and can only increase costs for consumers.

Similarly, one off bids could not be considered market distortions. Instead the AEC expects this prohibition would address sustained bidding practices inconsistent with the market design.

> **Proposed guiding principle**:
>
> *The ACCC will not commence action against any generator for engaging in bidding practices envisaged in the design of the spot market for which it is operating. This would include spot market bidding that takes into account a generators financial contract position.*
>
> *Where rules apply in the electricity laws preventing breaching conduct, it will be the exception, not the rule, for the ACCC to take action under the CCA.*
>
> *Any conduct would need to be material and sustained to draw consideration of action.*

ACCC Guidance on 'aggravated case' necessary

The distinction between the base case and the aggravated case is significant given the additional penalties that attach to s153H. The AEC therefore asks the ACCC to provide some detail in its Guidelines as to how it understands the circumstances which would give rise to an aggravated case as against the base case.

While fraud and dishonesty are common legal concepts and appear in various legislation, both require an understanding of the purpose of the party engaging in the fraudulent or dishonest behaviour. The same is true for the concepts of distorting or manipulating. When considering electricity markets, as set out elsewhere in this submission, there are many valid reasons for parties engaging in certain behaviour. For example, as noted above, the design of the market is intended to provide signals to investors, and instances of opportunistic bidding might appear distortionary *prima facie*, but rather, are reflective of the value of available capacity at particular times. The AEC therefore considers that it would be beneficial for the ACCC to develop an appropriate set of principles to utilise when it considers whether conduct might give rise to an offence of acting fraudulently and dishonestly or distorting or manipulating markets in the context of the NEM and electricity supply and generation markets, so that market participants are able to understand their obligations and can confidently act within the new restrictions imposed by the PEMM Act.

'Bad faith' is a concept that many market participants may be familiar with, but the interpretation of it is still uncertain. If the Guidelines fail to expand further on the concept of bad faith, this may result in varying concepts of bad faith (or assessments of good faith) being applied, and market participants would be unable to independently and confidently assess their conduct.

The AEMC faced a similar issue in relation to the 'bidding in good faith rule' under the National Electricity Rules, which was removed in favour of a prohibition against making false or misleading offers. The good faith rule was removed because it was unable to be determined by the courts. While the concept of 'bad faith' is not the same concept, the AEC considers that the ACCC will face similar issues in relation to understanding how the concept of bad faith should be interpreted without further clear guidance.

[14] AEMC 2015, Bidding in Good Faith, Final Rule Determination, 10 December 2015 , Sydney

Given the key role of the ACCC in identifying, and often enforcing the PEMM Act absent any input from the Courts, it is critical that broad, objective guidance is provided to electricity businesses in the Guidelines detailing how the ACCC intends to interpret 'bad faith'. The AEC prefers the ACCC to err on the side of caution, clearly specifying examples and principles around bad faith which only capture clear and intentional breaches of good operating practices. For example, the AEC understands that the concept of 'bad faith' has previously been considered to capture actions which are deliberately dishonest, unconscionable, misleading or deceptive, or fraudulent. The Guidelines should include a list of the characteristics that the ACCC will use to assess conduct as being in bad faith, ensuring it is interpreted in a manner consistent to existing provisions in the NER.

Part 2: ACCC processes and approach to investigations

Procedural fairness

The PEMM Act provides unprecedented powers to the ACCC to undertake its functions in a manner that may have an extraordinary impact on the operation of electricity businesses. Despite the seriousness of these powers, the PEMM Act does not explicitly require the ACCC to act in a manner that ensures the outcomes are just and fair. This is the case with regard to the unreasonably tight minimum timeframes in s153P, the relatively low burden of proof in s153L(1), and of greatest concern, the lack of a requirement to provide the affected business with a prohibited conduct notice or recommendation, or the supporting evidence, at the time it is given to the Treasurer. The AEC expects the ACCC to make clear in the Guidelines that it will ensure a just and fair process at all times for electricity businesses in enforcing its obligations. At times, this will require the ACCC to 'cover the gaps' in the drafting of the PEMM Act, ensuring that appropriate transparency, and input, is available to impacted businesses. This is particularly important where the PEMM Act permits the ACCC and Treasurer to make a determination as to liability and impose a remedy without reference to the Federal Court.

A graduating response

The AEC notes the broad range of penalties and remedies the PEMM Act provides the ACCC in undertaking its regulatory functions. These responses include a number of existing regulatory responses, available to the ACCC for other breaches of the CCA (including lower level administrative responses such as warning letters or requirements for offending companies to conduct training and audits). Beyond this, the PEMM Act also enables a number of extraordinary measures. The AEC seeks clarity from the ACCC as to when these extraordinary responses might be undertaken, including confirmation that they will only be utilised as a 'last resort' where the circumstances are such that the usual remedies of pecuniary penalty imposed by the court are not sufficient.

In particular, the AEC recommends that the Guidelines reflect the ACCC's existing compliance and enforcement priorities, including the priority factors.[15] This would mean that the ACCC is more focused on conduct that is of significant public interest or concern, or could result in substantial consumer detriment. In the event that conduct is appropriately resolved directly between parties, or where the relevant generator or retailer takes active steps to rectify conduct as soon as it is identified, a more administrative approach is appropriate. This reflects an appropriate graduating response, where the ACCC's enforcement actions are focused on the worst conduct and lesser conduct is managed through co-operative activity between the ACCC and the relevant generator or retailer.

[15] https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities#priority-factors

In developing the PEMM Act, the Federal Government continually highlighted that the PEMM Act would enable the ACCC, when it identified prohibited conduct through its ongoing price monitoring inquiry, to undertake a graduated set of remedies and responses. When, and only when, the existing remedies were considered incapable of mitigating the offending conduct, additional penalties including contracting orders and divestiture orders would be available. This sentiment should be reflected in these Guidelines, particularly in instances where these additional responses have lesser court oversight. To be clear, the Guidelines should set out that the ACCC will not make recommendations to the Treasurer to make a divestiture or contracting order without having first attempted to mitigate breaching conduct with an infringement notice or other remedy.

Clarification on use of remedies

Given the broad range of remedies allowed by the PEMM Act, the AEC considers it would be beneficial for the ACCC to provide some guidance to stakeholders as to when they might seek to utilise each remedy, particularly in instances where these remedies might have significant commercial impacts on electricity businesses.

Public notices

The power to issue public warning notices is one that can impose a significant penalty on a market participant, particularly in circumstances where no breach of the provisions has been proved. Given this, the AEC expects electricity businesses will always be provided with a draft notice, and an opportunity to respond, prior to its publication. The ACCC should confirm this in the Guideline.

Additionally, the AEC would encourage clarity in the Guidelines on the circumstances in which the ACCC would consider the "public interest" to be served by it issuing a public warning notice.

Contracting Orders

The powers provided in the PEMM Act to the ACCC and Treasurer in relation to contracting orders are extraordinary, and should be considered as such by the regulator. The powers permit a Treasurer, on the recommendation of the ACCC, to impose a potentially financially onerous obligation on a market participant on the basis of a 'reasonable belief' that the participant has breached one of the PEMM provisions, without any recourse to the Federal Court or the laws of evidence. The AEC is very firmly of the view that the ACCC must treat these powers with great caution and exercise them sparingly and with great responsibility and restraint. Any recommendation from the ACCC to the Treasurer to use the contracting order powers should only be made in circumstances where the ACCC is satisfied that a recourse to the usual powers is demonstrably not sufficient. While guidance on how the ACCC intends to recommend contracting orders would be beneficial, the AEC is conscious of the need to ensure this does not lead to overuse in circumstances where such use would not reflect future market conditions.

On this basis, the AEC asks the ACCC to outline in the Guidelines its view on the following:

- When might the ACCC consider a contracting order to be a proportionate response?
- What nexus would the ACCC believe needs to exist between the impugned conduct and the recommended contracting order?
- What approach will the ACCC take (and to what extent will the ACCC be involved in) the drafting of proposed contracting orders for the Treasurer, including the detailed terms in relation to volume, price, duration, parties etc.?

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Divestiture remedy

Similarly, the power of the Court to impose a divestiture order is an extraordinary one, and one that the ACCC and Treasurer should seek to invoke only in the most extreme circumstances. The EM makes clear that a *"court ordered divestiture is intended to be used as a last resort in the most exceptional circumstances where other responses available to the ACCC and the Treasurer would not sufficiently address the alleged prohibited conduct".*[16] The EM also recognises that divestiture is a significant deterrent and it may never be necessary to use this power.[17] Given the nature of divestiture, the AEC seeks greater clarity in the Guidelines as to how the ACCC might utilise this power:

- When might the ACCC consider divestiture to be a proportionate response to prohibited conduct?
- How would the ACCC determine the impact of a divestiture order on remaining parts of a business?
- The ACCC should highlight that it may allow more than 12 months for disposal of the interests in the securities or assets, taking into account the likely market for buyers of the relevant securities or assets.
- Can the ACCC clarify what happens if there is no buyer – or no buyer on just terms – that represent the true value of the asset or interest to the corporation?

Related body corporate

The AEC seeks greater clarity from the ACCC about how it will enforce the connected body corporate provisions in section 153D of the PEMM Act. In particular, the ACCC should clearly set out how the concept of 'connected body corporate' interacts with the existing concept of 'related body corporate', which is already defined in section 4A of the CCA, as there appears to be some overlap.

Of greatest concern is the apparent capture of related entities, unconnected to the allegedly prohibited conduct. In practice, we expect that if an entity that owned two generating units was found to breach the contracting prohibitions in section 153F, a potential contracting order should only be made with regard to the operation of the offending unit, unless the other unit also directly contributed to the breach. Without further clarification of this point from the ACCC in the Guideline, the fact that the definition of 'connected body corporate' captures indirect use and dealings seems likely to mean that the application of the PEMM Act will apply to entities who have no direct control over, and no clear involvement in, the offending conduct. The AEC considers that this scope is too broad and that the ACCC's enforcement actions should be restricted to more direct involvement in the allegedly offending conduct.

Approach to information gathering

But for conduct identified by the ACCC as part of its Electricity Market Monitoring inquiry, the AEC expects that any interactions between the ACCC and electricity businesses will be conducted utilising its specific investigatory powers in section 155 of the CCA, rather than its broader information gathering powers in section 95ZK. In the event that the ACCC is investigating specific conduct, rather than broadly monitoring the performance of the market under a market inquiry, the AEC considers that the protections and processes which apply to notices issued under section 155 of the CCA are essential.

Further, given that sections of the PEMM Act will continue to apply after the completion of the broader energy market inquiry, the AEC considers that the ACCC should be relying on its standard information gathering powers (i.e., section 155) which will continue to apply to the electricity industry after the completion of the market inquiry (as opposed to the section 95ZK power, which will not apply after 2025).

[16] EM 5.7
[17] EM 8.53

Implementation

The AEC notes that the timeframe available for the ACCC to finalise and publish these guidelines is very tight. The PEMM Act is due to commence on 10 June 2020, and the ACCC already anticipates its Guidelines will not be finalised until sometime in May 2020. The AEC is concerned that electricity businesses will not have adequate time post the publication of the final Guidelines to effectively implement the required systems and processes necessitated by the Guidelines themselves. Whilst the AEC appreciate this time constraint is not of the ACCC's choosing, we would welcome consideration when developing and finalising these Guidelines about their effect on electricity businesses, and particularly, the ability of businesses to comply just a few weeks after the final Guidelines are issued.

The PEMM Act has been widely regarded as an extreme incursion into the energy sector, with significant risk of unintended consequence. Given the severity of the penalties for non-compliance, it is our expectation that the ACCC will conduct an open, collaborative, and reasonable process to ensure there are no surprises when the final Guidelines are published, and ensure just and fair timeframes for electricity businesses to implement the Guidelines prior to enforcement action commencing. This would be consistent with the ACCC's compliance and enforcement policy. The AEC accepts this will not be appropriate where a participant has not exercised sufficient care or concern for their new obligations.

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

Yours sincerely,

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