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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Parkes ACT 2600

By email: economics.sen@aph.gov.au

Dear Committee

Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019

The Australian Industry Group (Ai Group) welcomes the chance to make a short submission regarding the above Bill for an Act to amend the *Competition and Consumer Act 2010 (Cth)*(CCA).

Ai Group's members comprise businesses of all sizes across Australia. While some of our members are involved in energy supply, the vast majority are energy users. They have a strong interest in ensuring the supply of affordable, reliable and clean energy, including through a predictable regulatory environment that fosters investment.

Ai Group maintains the views set out in our January 2019 submission to the Committee on the previous, and very similar, version of this Bill. In input to the Committee and the Government we have consistently stated a strong preference for market mechanisms and predictable energy policy to encourage efficient investment in the energy sector and help to lower electricity prices. Whilst we have acknowledged the need for some additional provisions in the CCA to target specific conduct in the sector, disproportionate intervention in the electricity market would have an adverse impact on sustainable and effective investment in the electricity sector, thereby harming the long-term interests of energy consumers.

The latest Bill has been only lightly amended and does not substantially respond to these concerns. While we acknowledge that the Government took its broad approach to the recent Federal Election, the proposed legislation needs, at a minimum, substantial amendment.

The state of the electricity market

The background to this Bill is the surge in wholesale and retail electricity prices across the National Electricity Market (NEM) since late 2016.¹ Energy prices are the most frequent concern raised by Ai Group's members, and a significant headwind to many businesses with otherwise strong prospects. While network cost growth contributed much to the rise of electricity prices from 2010-15, since late 2016 nearly all price pressure has come from the rise in wholesale prices. This increase has come about for several reasons:

1. The rise of Liquefied Natural Gas exports from Queensland has caused wholesale gas prices to triple from their long term average. This has been driven by linkage of the local market to international oil and gas price pressures; and by the increased production and

¹ While the separate Western and Northern markets are also important, most current energy user concern relates to developments in the NEM.

- transport costs of the new gas resources needed to meet tripled gas demand.
2. Gas-fired electricity generators, which provide critical flexibility for the electricity system, have consequently experienced a steep rise in operating costs. High prices for export-grade thermal coal have similarly affected some coal-fired generators.
 3. The retirement of multiple ageing coal-fired electricity generators without much notice took the market from substantial oversupply to a very tight balance, greatly increasing the price-forming role of gas fired generation.
 4. New renewable energy projects have been expected to reduce the volume of generation from gas and lower average wholesale prices, even though they are generally not able to play gas generators' flexible role. However there have been significant delays in the rollout of projects, associated first with the legacy of the Renewable Energy Target amendment debate, and more recently with connection issues and Marginal Loss Factor changes.
 5. Existing generators have had or are expected to have constrained output, due to drought affecting Snowy Hydro storages; coal supply challenges impacting some NSW generators; and serious breakdowns at coal and gas generators, particularly in Victoria.

These are the fundamentals that have driven recent electricity price rises, not market misconduct. Futures prices indicate that wholesale electricity prices will decline by 20-30% over the next two years, as the current surge of renewable energy investment eases the supply-demand balance. However, further retirements of old capacity – or involuntary outages of ageing assets – will require further preparation and investment over the coming decade. Measures that do not address and respond to the fundamental shifts and risks in the market are not just a waste of time. If they deliver a more unpredictable and hostile investment climate, they make it more likely that current extreme prices persist or return with a vengeance.

Problems with the Bill

The Bill sets out:

- three additional prohibitions regarding conduct in the electricity supply chain, regarding retail pricing, financial contracts and the wholesale spot market; and
- a range of remedies from public warning notices issued by the Australian Competition & Consumer Commission (ACCC), to orders for businesses to enter into financial contracts, to orders requiring businesses to divest specified assets.

We question the need for these additional prohibitions in the CCA given their vagueness; the comprehensive range of existing legislative prohibitions to address any misuse of market power (section 46), exclusive dealing (section 47) and misleading and deceptive conduct (section 18 of Australian Consumer Law); the reintroduction of retail price regulation through the Default Market Offer (DMO) and Victorian Default Offer (VDO); and the inclusion of a regulator-administered Market Liquidity Obligation (MLO) in the Retailer Reliability Obligation (RRO), which would address financial contract availability in the event that a reliability shortfall creates a tight market.

The retail element creates complex new concepts that would be difficult to establish either way, including what the 'underlying cost of procuring electricity' is and whether a downward movement in that cost is 'sustained and substantial'.

The financial market element prohibits a failure to act (rather than an affirmative action) which would lead to interminable disputes about the practical ability of an entity to offer financial contracts, and combines this with equally arguable intentionality.

The wholesale element potentially prohibits any sort of activity in the spot market if done with the wrong intent.

In short, these proposed provisions add nothing but difficult concepts to the existing state of competition law.

We also question the need to introduce the additional remedies since the CCA provides the ACCC with wide ranging and appropriate compliance and enforcement powers. In particular, we oppose the proposals for divestiture orders and contracting orders. Any perceived benefits from these remedies need to be considered against a background of on-going uncertainty and policy failure in the energy sector and its impact on financially sustainable future investment, and the poor precedent that would be set for the wider economy.

Given the complexity of the NEM and the ongoing need for efficient investment to sustain the essential service it delivers, it is imperative to design a competition framework which does not unduly interfere with efficient risk management structures or distort market clearing mechanisms and responses. In particular, it is essential to avoid penalizing participants in the electricity supply chain for legitimate commercial and operational activities, which ensure the financial viability of their operations.

We do not support the provisions in the Bill which would create a power to require a corporate entity to divest some or all of its assets. The ACCC's pricing inquiry final report referred to the divestiture of privately owned assets as an 'extreme' measure and specifically refused to recommend this step.² Similarly, the Harper Competition Policy Review recommended in 2015 against creating a new power of divestiture as a response to misuse of market power in any sector of the economy.³ We believe that the divestiture element of this Bill would undermine the National Electricity Objective as stated in the *National Electricity Law*, which is to 'promote efficient investment in and efficient operation and use of electricity services for the long-term interests of consumers of electricity'. The threat of divestiture or involuntary restructuring presents further deep uncertainty for an electricity sector that needs to invest to meet energy users' needs and is already struggling with an opaque and chaotic policy landscape.

Preferred approaches

Ai Group believes that the adoption of key recommendations from the ACCC's retail pricing inquiry final report,⁴ the ACCC's ongoing monitoring of electricity retail, contract and wholesale markets from 2018 to 2025 and the existing provisions in the CCA for anti-competitive conduct are the right response to competition issues in the NEM. The ACCC recommendations and other reforms underway will help address supply side and demand side inefficiencies in electricity markets, improve transparency, reduce information asymmetries and lead to lower prices for electricity consumers. The relevant reforms include:

- Recommendation 21 – Mechanism for wholesale demand response (a widely rule has been proposed by the Australian Energy Market Commission (AEMC) for commencement in 2022);
- Recommendation 23 – Allowing distributors to develop off-grid supply arrangements for

² Australian Competition & Consumer Commission, *Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry – Final Report*, June 2018, p. 90

³ Harper et al, *Competition Policy Review: Final Report* (March 2015) p. 347

⁴ Australian Competition & Consumer Commission, *Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry – Final Report*, June 2018

- existing customers or new connections (the AEMC has set out a pathway for this and is developing customer protections for off-grid supply by parties other than distributors);
- Recommendation 30 – Default market offer to be set by AER to replace standard offering and standard retail contract (the DMO and VDO are now in force);
 - Recommendation 31 – Adoption of a consumer data rights framework (now under development by the ACCC);
 - Recommendation 32 – Adoption of AER default market offer as a reference point for all advertised discounts (adopted);
 - Recommendation 34 – Establishing a mandatory code of conduct for energy comparator websites (adopted);
 - Recommendation 40 – Retail price monitoring and reporting should be strengthened and appropriately funded to ensure greater transparency in the market (adopted);
 - Recommendations 40, 42, 44, 45, 46, 47, 48 – Multiple improvements to the National Electricity Law and associated rules to strengthen and graduate enforcement (underway).

In addition, the recently introduced RRO MLO will, if and when the RRO is triggered, require at least two large integrated retailers in each NEM region to offer financial contracts. Ai Group supports the MLO as a neutral, clear and appropriate response to existing and potential future limitations on the liquidity of contract markets. By contrast the approach in the Bill, prohibiting a failure to offer contracts under certain circumstances and intention states, is vague and unpredictable. It is excessively broad while likely being difficult to use in practice.

The best outcome would be to fundamentally reconsider this Bill. However, we note the specific amendments proposed by the Business Council of Australia, which overall would amount to a considerable improvement on the current Bill if adopted. These improvements include:

- Substituting objective Australian Energy Regulator assessment of DMO and VDO price movements for individual retailer self-assessment of ‘sustained and substantial reductions’ in electricity costs;
- Harmonising with existing misuse of market power provisions;
- Harmonising with existing bidding rules;
- A hybrid model for contracting orders, with Court decision-making on the basis of Regulator advice; and
- Removing the divestiture orders remedy.

Conclusion

A strong wave of investment is underway in renewable energy, initially inspired by the RET but now also supported by a tight generation market and the emerging corporate power purchase agreement market. However, this wave is clearly slowing and much more investment is going to be required in the coming decade to provide the new and upgraded cheap generation, flexible resources and supporting infrastructure to meet our needs and replace continuing retirements.

Unfortunately, ongoing uncertainty over national energy and climate policy has greatly exacerbated the underlying uncertainty of investment in a market undergoing fundamental changes to technology and business models. Prices are high. Reliability is under greater pressure. Australia’s economy-wide emissions continue to rise. In other words, we are failing on all elements of the ‘energy trilemma’ identified by the Finkel Review, despite the considerable progress underway on energy market and policy reforms in recent years. Investment to remedy these problems will be lower and slower than it should be if there is no improvement in policy uncertainty.



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Ai Group strongly believes that given the existing level of uncertainty in the energy sector, further measures to force business entities to restructure or divest some or all of their assets, risks having a materially detrimental impact on their existing commercial operations and investment strategies. These risks apply to all private participants in the generation sector, not just large incumbents. More generally, creating a power to break up energy businesses would set a poor precedent for disproportionate government intervention in the wider economy. It will raise deep reservations among domestic and international institutional investors regarding investment in Australia, including in the infrastructure sector.

Should you wish to discuss the matters raised in this letter, please contact our adviser Tennant Reed on 03 9867 0145 or tennant.reed@aigroup.com.au.

Sincerely yours,

A handwritten signature in blue ink that reads 'Innes Willox', underlined with a blue horizontal line.

Innes Willox
Chief Executive