

SUBMISSION TO SENATE LEGISLATION COMMITTEE INQUIRY INTO TREASURY LAWS AMENDMENT (PROHIBITING ENERGY MARKET MISCONDUCT) BILL 2018

Introduction

The Senate Legislation Committee invited me to make a submission on the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018*. I was Minister for Competition Policy and Consumer Affairs 2009-2010 and am now Managing Director of Craig Emerson Economics Pty Ltd. I am a regular columnist with *The Financial Review*.

My submission focuses on two aspects of the bill: prohibited conduct in relation to electricity retail prices, and the proposed remedy of forced divestiture for prohibited conduct in relation to the electricity spot market.

While the Government has proposed amendments to the original bill (including changing its title), the amended bill would constitute the largest intervention by a government into a market of any ever contemplated under the *Competition and Consumer Act 2010* and its predecessor, the *Trade Practices Act 1974*. It would amend the *Competition and Consumer Act 2010* to single out the electricity supply industry for a form of price control and for forced divestiture of generating assets.

The bill would constitute the largest-ever peacetime intervention by a government into a market.

Price controls

The bill prohibits conduct in retail electricity markets that can “lead to poor outcomes for electricity consumers.” Specifically, it obliges electricity retailers to pass onto consumers savings in supply chain costs. So complex are the obligations on retailers that the Explanatory Memorandum gives no fewer than 11 illustrative examples of circumstances in which cost reductions must, and need not be, passed on – and these 11 examples are by no means exhaustive. Consequently, electricity retailers will not be in a position to know whether or not they are engaging in prohibited conduct until cases are clarified by the courts. Typically, the development of such case law can take a decade.

Electricity retailers will face great uncertainty as to whether or not they are engaging in prohibited conduct.

Consider a situation where the government of the day threatens electricity retailers with new legislation if they do not reduce their prices at a politically sensitive time. This is precisely what the present Australian Government has done with its “big stick” legislation. If retailers agree to freeze their prices in response to this pressure, despite rising wholesale electricity prices, and

subsequently seek to recoup some of their margin reductions or losses when costs fall, they would likely be engaging in prohibited conduct.

The effect of the bill is to fix the retail margins of electricity suppliers. The allowable margins are those obtainable when wholesale prices and other supply-chain costs are at their peaks. When wholesale prices and other costs fall, the retailers are obliged to reduce their retail prices commensurately.

Yet, based on the laws of supply and demand, margins are likely to be slimmest when costs are at their highest. This bill regulates retail prices in such a manner as to minimise electricity retail margins. While this might be politically popular, it is short sighted. Markets work best for consumers when they are competitive. That is the whole rationale of the *Competition and Consumer Act 2010* and its predecessor, the *Trade Practices Act 1974*.

By regulating retail margins at their lowest-possible levels, the bill is anti-competitive in effect, making new entry into the electricity retail market unattractive.

While the Government might hope the bill reduces electricity prices in the lead-up to an election, by stifling competition and innovation the bill inevitably will increase electricity prices thereafter.

By stifling competition and innovation, the bill inevitably will lead to higher electricity prices.

Forced divestiture

The *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018* provides that if the ACCC reasonably believes that a corporation has engaged in certain prohibited conduct in relation to the wholesale electricity market, then the ACCC may recommend that the Treasurer make an application to the Federal Court seeking an order directing the corporation to divest specified assets.

Following the receipt of such a prohibited conduct recommendation from the ACCC, the Treasurer may apply to the Federal Court for an order directing a corporation identified in that recommendation to dispose of its interests in securities or assets that are part of its electricity business.

In respect of a government-owned electricity generator that is subject to forced divestiture, the government-owned corporation can divest to another government-owned corporation if it is genuinely in competition with the corporation subject to the divestiture order.

This means that a divestiture order would allow a government-owned corporation to dispose of assets to another government-owned corporation, but *only if* they are not an associated entity and *if* they are genuinely in competition with each other.

Unless these specific conditions are met, the bill therefore requires that a forced divestiture of a government-owned electricity generator must be to a private corporation, effectively requiring the privatisation of electricity generators.

The forced divestiture provisions of the bill can require the privatisation of government-owned electricity generators.

Under the existing *Competition and Consumer Act 2010* the only circumstances in which court-ordered forced divestiture can be contemplated are where an acquisition has occurred that has the effect or would be likely to have the effect of substantially lessening competition, or where the ACCC has granted an authorisation for an acquisition that is based on false or misleading information provided by the applicant.

The ACCC has made it clear that it was not consulted on the proposed policy of forced divestiture¹ and did not recommend it to the Government: "... because it has such big implications, is a difficult judgement to form ... Divestiture is such an extreme step that we felt that judgement would be very hard to reach."²

The Regulation Impact Statement (RIS) attached to the Explanatory Memorandum for the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018* states in relation to forced divestiture that "potential investors in the electricity sector should not be deterred by the legislative framework, unless their intention is to engage in conduct which is detrimental to competition or consumer welfare."

This is at best naïve and at worst insulting. Foreign investors in particular will assess the sovereign risk associated with investing in electricity generation in Australia. The inclusion in the *Competition and Consumer Act 2010* of a forced divestiture provision for electricity generation, where no such provision has existed in that act or in its predecessor *Trade Practices Act 1974*, is a material consideration in any rational assessment of the level of sovereign risk.

For the RIS to accuse any potential investor who rationally takes account of this source of sovereign risk of intending to engage on conduct that is detriment to competition or consumer welfare is itself a source of sovereign risk in Australia.

By accusing any foreign investor concerned with the sovereign risk associated with the new forced divestiture provision of intending to engage in anti-competitive conduct, the Government's Regulation Impact Statement is itself a source of sovereign risk.

Precedents for other industries

¹ Hansard of Senate Estimates, 25 October 2018, p. 4.

² Hansard of Senate Estimates, 25 October 2018, p. 12.

The regulation of electricity margins and forced divestiture provisions contained in the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018* create obvious precedents for other industries. Inevitably the amendments would be extended to petrol, supermarkets, agriculture and, in time, to all sectors of the Australian economy.

Regulatory control of prices is a feature of economies such as those of Venezuela, Cuba, North Korea and the former Soviet Union. None of those economies can be said to have maximised consumer welfare. The *Trade Practices Act 1974* introduced by the Whitlam Government and the *Competition and Consumer Act 2010* introduced by the Rudd Government were designed to promote competition for the benefit of consumers. Introducing price controls and forced divestiture provisions would be detrimental to competition and consumers.

Already, National Party figures have foreshadowed extending these provisions to the rest of the economy. Former Deputy Prime Minister Barnaby Joyce and Nationals Senator Barry O'Sullivan have indicated that forced divestiture powers for electricity retailing would be a good first step on the way to a general divestiture power, with O'Sullivan stating they are not alone in the party room. There is every prospect of the Nationals insisting on the inclusion of a general forced divestiture and price regulation provision in the next Coalition agreement, details of which are routinely kept secret.

The price control and forced divestiture provisions of this bill create a precedent for their extension to the whole economy.

Concluding remarks

As Minister for Competition Policy and Consumer Affairs, I declined to include forced divestiture powers in the *Competition and Consumer Act 2010*. Nor did I receive a recommendation to include such powers from the then-Chair of the ACCC. The current Chair of the ACCC has publicly stated that he does not support such provisions as contained in the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018*.

Price regulation of privately provided services such as electricity, and forced divestiture of generating assets, might be politically popular in the short term but would stifle foreign investment, competition and innovation in electricity supply, forcing electricity prices up sooner rather than later.