Queensland Government

The Hon Dr Anthony Lynham MP
Minister for Natural Resources, Mines and Energy

Ref CTS 37049/18

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Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600
AUSTRALIA

Dear Mr Fitt

Re: Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018

The Queensland Government welcomes the opportunity to provide a submission on the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018* (the Bill) to the Senate Economics Legislation Committee.

The consultation process conducted by the Commonwealth Government for this Bill has been entirely inadequate, bypassing important discussions with the states and territories that are responsible for shared governance of the electricity market and will be directly impacted by the proposed legislation.

There has been no consultation with Queensland and as a result, the legislation reflects a lack of understanding of Queensland's unique circumstances. In particular, I requested a copy of the legislation from the Commonwealth Treasurer on two separate occasions prior to it being introduced to Federal Parliament on 5 December 2018. The Queensland Government received no response to these requests despite media reports indicating that the legislation had been leaked and a limited circulation copy was being distributed to certain stakeholders.

This lack of engagement is unacceptable given the significance of the legislation for the electricity sector, as well as Queensland's role in the Council of Australian Governments (COAG) Energy Council, and position as owner of substantial electricity generation assets.

This process has not been conducted in the spirit of the Australian Energy Market Agreement (AEMA), an intergovernmental agreement between states, territories and the Commonwealth Government that sets out the governance arrangements for Australia's energy markets. Under this agreement, jurisdictions and the Commonwealth should be working together to provide oversight and coordination of energy policy development to ensure effective integration.

The Queensland Government calls on the Commonwealth to bring discussion of these issues to the COAG Energy Council and work collaboratively with jurisdictions to implement measures that are in the best interests of consumers. All jurisdictions are concerned with any potential for

market misconduct. However, any solution developed in isolation will be ineffective and likely to drive up costs and risks in the sector.

The Bill being considered by the Senate Economics Legislation Committee outlines the Commonwealth's proposal for new electricity sector prohibitions and remedies, as well as new powers for the Australian Energy Regulator (AER). The Queensland Government has a number of critical concerns with the Bill, namely:

- The impact of uncertainty on investment decisions across the sector;
- The potential for privatisation of assets;
- The impact of default prices on consumers; and
- The potential conflicts with Queensland legislation and policies.

The impact of uncertainty on investment decisions across the sector

The Bill outlines remedies that can be applied to address prohibited conduct identified in the electricity sector. This includes a 'Divestiture Order', which can be made by the Federal Court upon application by the Commonwealth Treasurer, and a 'Contracting Order' which can be made by the Treasurer. The vague definitions of prohibited conduct in the Bill, and severe nature of these proposed remedies are highly problematic for the energy market broadly.

Industry groups have consistently cited uncertainty as a key factor in driving up costs by increasing the risk associated with investment decisions. This Bill generates significant uncertainty due to vague definitions and terms in the legislation that could have unclear applications. For example, concepts that are likely to cause difficulties in terms of their interpretation and application include:

- 'reasonable adjustments' (Section 153E(b));
- 'sustained and substantial reductions' (Section 153E(b)); and
- 'underlying cost of procuring electricity' (Section 153E(b)).

The Explanatory Memorandum includes scenarios which highlight that the meaning of these terms will vary depending on the specific circumstances of each retailer, making the requirements for compliance opaque for market participants. For example, consideration of what constitutes reasonable adjustments to price is broad and vague, with the Explanatory Memorandum signalling that overall operating costs will be relevant, and can include costs across multiple arms of a business, or across a business that may operate in multiple jurisdictions. While the Explanatory Memorandum notes that the legislation is not intended to undermine a corporation's viability or risk management strategies, this remains a fundamental challenge with the ambiguous and subject nature of the terms.

As a result of the uncertainty in the intended meaning and effect of some of the provisions in the Bill, there is a risk that they will operate in a manner that is not contemplated or intended by the legislation. This makes compliance difficult for market participants. This is exacerbated by the significant remedies that are in the Bill such as Divestment Orders and Contracting Orders, forcing corporations to sells assets or contract with third parties.

Divestiture and Contracting Orders are severe remedies that need to be adequately justified within a clear enforcement framework. As provided for in the Bill, they do not cultivate a market where players are willing to invest due to the increased sovereign risk of those investments. The uncertainty these remedies generate in the market will result in poor consumer outcomes by destabilising the investment environment and driving unnecessary risk and costs into the system.

In its submission to the Australian Competition and Consumer Commission's (ACCC) consultation paper on monitoring into electricity supply in the National Electricity Market, the

Australian Energy Council (AEC) noted that policies such as the interventionist provisions included in the Bill "can prevent new players from entering the market, distort price signals required for investment and reduce healthy competition".

Additionally, the AEC noted in its submission to the Commonwealth Government's consultation paper on its proposed electricity price monitoring and response legislative framework that "...notwithstanding the Government's intentions, the approach set out in the Bill would produce negative impacts for all consumers by increasing perceived regulatory risk and accordingly increasing the cost of investment necessary for the market's further development".[1]

A similar observation was expressed by the Energy Security Board (ESB) in its Health of the National Electricity Market (NEM) report released 20 December 2018. In this report, the ESB rated the status of "strong but agile governance" in the NEM as critical, on the basis of an observed "piecemeal approach to setting energy policy". The ESB in particular noted that it is "not helpful for the Commonwealth Government to be threatening powers of divestment, price setting and discretionary asset write-downs".[2]

Investment is critical to a functioning electricity market. It ensures ongoing supply of electricity to consumers at an efficient price, and drives the transition to a more consumer focussed market that contributes to Australia's national commitments for reducing emissions. Ambiguity in this Bill as to what constitutes prohibited conduct, and the threat of severe penalties such as Divestment or Contracting Orders, increases the risk of investment and drives uncertainty and costs into the sector and puts these outcomes at risk.

The potential for privatisation of assets

A Divestiture Order, requested by the Treasurer, allows the Federal Court to direct a corporation to dispose of interests in securities or assets if that corporation has engaged in prohibited conduct. The Bill outlines at a high level what this prohibited conduct would be.

The Bill includes an exception that would allow corporations that are an Authority of the Commonwealth or a State/Territory to dispose of assets to a related or associated government Authority (s153ZB(3)) in certain circumstances.

This exception appears to partially address concerns regarding the privatisation of public assets, however there remains some uncertainty about the definition of key terms, and how the provisions in the Bill would be practically applied to Queensland Government Owned Corporations (GOCs), and GOC subsidiaries. Given these uncertainties, there remains a significant risk that the Bill creates pathways for the privatisation of public assets which would be unacceptable to the Queensland Government. These pathways are:

- Pathway 1: entity is not a "State Authority" but holds public assets
- Pathway 2: entity is a "State Authority" but is not "genuinely in competition"
- Pathway 3: privatisation prompted by Commonwealth action against a GOC

Pathway 1: entity that is not a "State Authority" but holds public assets

The exception for State Authorities in the legislation appears to apply to Queensland GOCs, but it is unclear, based on the definition of a State Authority in the *Competition and Consumer Act 2010* Section (4)1, whether this exception would apply to a subsidiary of these organisations, such as Ergon Energy and Energex.

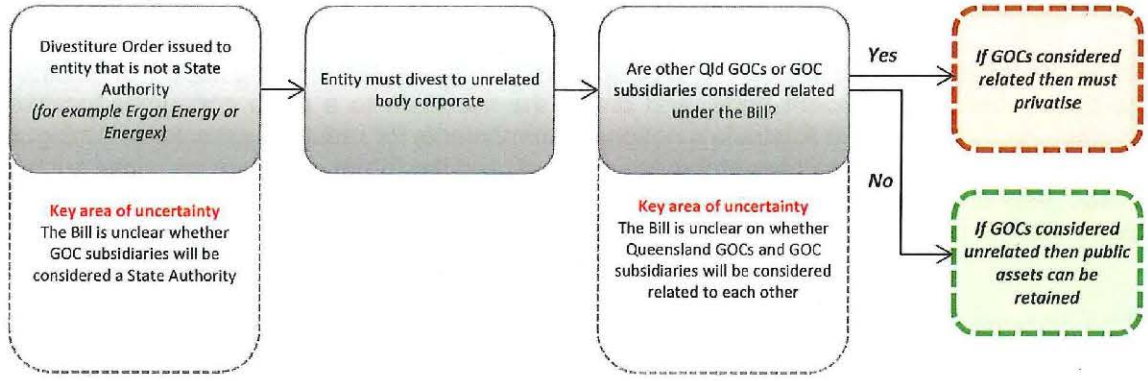
[1] Submissions available at: https://www.energycouncil.com.au/submissions/
[2] Available at: http://www.coagenergycouncil.gov.au/publications/health-national-electricity-market

Due to the uncertainty around this term and how it would apply in the Queensland context, there is a risk that a Divestiture Order which targets public assets owned by a subsidiary of a Queensland GOC, could be required to privatise these assets.

While it may be possible for corporations under a Divestiture Order that do not qualify as State Authorities (potentially GOC subsidiaries) to sell assets to another Queensland GOC if that entity is considered unrelated (thereby retaining assets in public ownership), this depends on how other Queensland GOCs are defined in relation to each other. Specifically, whether they constitute related body corporates or associates.

Due to the unclear nature of these key terms in the Bill, the legislation may provide a pathway for privatisation for an entity that is not a State Authority, even though it holds public assets, as depicted in Figure 1 below.

Figure 1: key issues of concern in relation to pathway 1

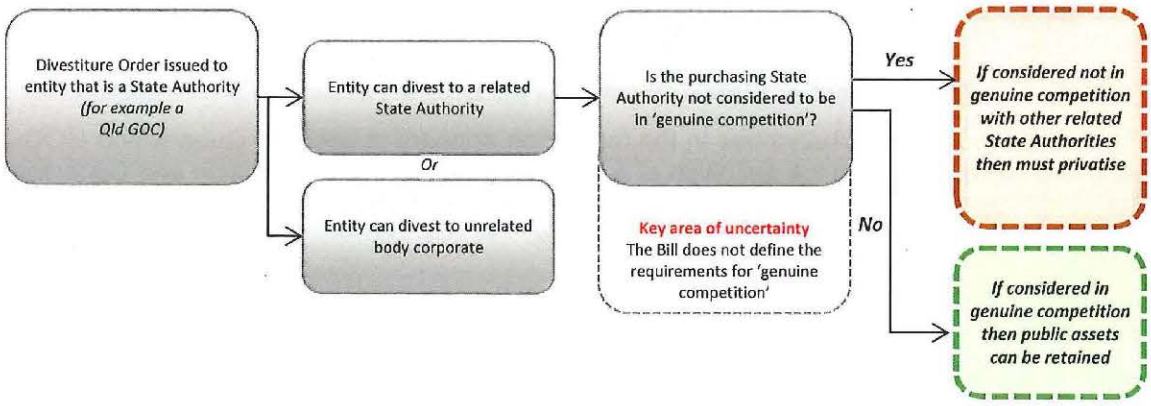


Pathway 2: entity is a "State Authority" but is not "genuinely in competition"

The Bill allows entities subject to a Divestiture Order that are State Authorities (for example Queensland GOCs) to dispose of assets to related State Authorities. This exception for State Authorities includes a qualification that the Authorities are 'genuinely in competition in relation to electricity markets' (s153ZB(3)(c)).

In this context, the meaning of genuine competition is not defined and it is unclear how this would be assessed. There are a number of different definitions and considerations at law for understanding whether two parties are in competition, and the Bill does not provide clarity on how this would be applied. It is also unclear how a newly formed entity would be considered in this context. This potential pathway for privatisation is depicted in Figure 2 below.

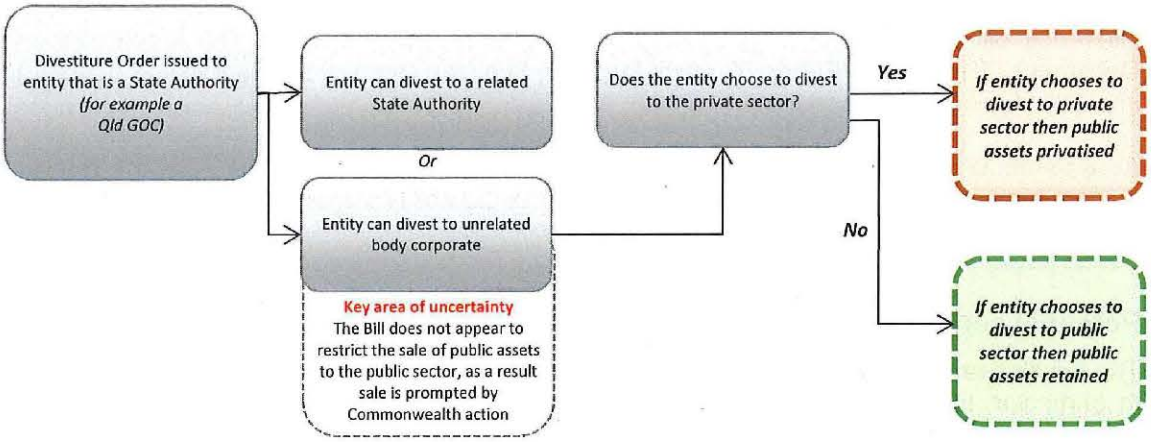
Figure 2: key issues of concern in relation to pathway 2



Pathway 3: privatisation prompted by Commonwealth action against a GOC

As described above, the Bill allows entities subject to a Divestiture Order that are State Authorities (for example Queensland GOCs) to dispose of assets to related State Authorities. However, there does not appear to be any restrictions applied to prevent selling these assets to the private sector. As such, the State Authority subject to the Divestiture Order could dispose of assets to the private sector. This privatisation would be directly prompted by Commonwealth action rather than by the state government as shareholder and would need to be completed in line with the terms of the Divestiture Order, diminishing the likelihood of achieving the maximum value for that asset (depicted in Figure 3 below).

Figure 3: key issues of concern in relation to pathway 3



Privatisation is an unacceptable outcome for the Queensland Government and legislation that creates pathways for privatisation against the intent of the Queensland Government and people of Queensland cannot be supported.

The impact of default prices on consumers

The Bill proposes amendments to Schedule 2 of the *Competition and Consumer Act 2010* (Cwlth) (CCA) to give the AER broad new powers relating to the regulation of retail electricity prices. The Explanatory Memorandum indicates that the new powers are intended to facilitate the implementation of the Commonwealth's proposed default market offer, as recommended by the ACCC's Retail Electricity Pricing Inquiry.

In particular, the Bill proposes to extend the existing regulation-making power to prescribe a retail electricity industry code (under s.51AE of the CCA) to allow the AER to compel retailers to not exceed default prices determined by the AER and contained in the code.

At its October 2018 meeting, the COAG Energy Council asked the AEMC to assess the potential customer and competition impacts of setting a default offer. On 20 December 2018, the Australian Energy Market Commission published its advice to the COAG Energy Council in relation to the default offer.

The AEMC noted the significant risks of a default offer; in particular, the potential to reduce competition and stifle innovation. These risks included:

- an increase in prices for at least some customers on market offers;
- an increase in standing offer prices that are currently set below the cap;
- a decrease in the range of offers available in the market;

- lower levels of innovation as 'discounts off the standing offer' becomes the most common offer; and
- higher barriers to entry for new retailers, as well as changes in consumer behaviour, resulting in decreased competition in the energy retail market and ultimately higher average prices for consumers.

Based on the declining proportion of customers on standing offers (expected to be less than 10 per cent within the next two years) and the risks associated with the proposed default offer, the AEMC's advice noted that caution would be needed if the default offer was to be introduced as a regulated price cap.

Rather, as an alternative, the AEMC has recommended work be progressed to develop a reference bill (comparison rate) to help consumers compare offers in the market. At the December 2018 COAG Energy Council meeting, Ministers agreed to use existing powers to implement this recommendation.

As a result, it is considered that the sections of the Bill which provide the AER the relevant powers regarding setting a default offer price, namely the ability to make legislative instruments, should no longer be required.

Potential conflicts with Queensland legislation and policies

The Bill also raises concerns relating to its interaction with Queensland legislation and policies. In particular, the Queensland Government's direction powers over the Queensland Energy GOCs, and potential conflicts with the *Electricity Act 1994* (Qld) regarding price regulated regions in Queensland.

Under the *Government Owned Corporations Act 1993* (Qld) the Queensland Government has the ability to give directions to the Queensland Energy GOCs to take particular actions in the public interest. These direction powers enable the Queensland Government to take action to benefit Queenslanders.

Most recently, the Queensland Government has directed its businesses to achieve affordability objectives under the Powering Queensland Plan, by directing Energy Queensland to remove the costs of the Solar Bonus Scheme from network charges until 2020, and directing Stanwell Corporation to undertake actions aimed at placing downward pressure on wholesale prices.

Any conflict with Commonwealth legislation could undermine the Queensland Government's ability to use these directions powers to benefit Queenslanders. Further, there is nothing in the Bill requiring the Treasurer or Federal Court to take into account broader public policy objectives if there were a potential conflict with a direction provided to a GOC.

The Bill also raises a potential conflict with price regulated regions in Queensland and creates significant uncertainty for retailers in that region. The Bill applies nation-wide, including areas that are not connected to the National Electricity Market. This would capture price regulated regions in Queensland where the Minister and Queensland Competition Authority (QCA) make price determinations.

The Bill appears to include an underlying assumption for prohibited conduct relating to retail prices that retailers have the ability to set their own prices in these regions, however this is not the case for price regulated areas.

When the ACCC contemplated this issue in its Retail Electricity Pricing Inquiry and recommended a default offer price, it also recommended that this would require an extension of the derogations that enable the ACT, Queensland and Tasmania to manage their regulated

price-setting arrangements. There does not appear to be similar considerations as part of this Bill in relation to Queensland's price regulated regions.

Conclusion

In summary, the Bill is vague in critical sections which generates uncertainty for its application. It also introduces highly interventionist remedies that have not been used before in the energy sector without adequate justification or safeguards. It raises significant concerns in the way it interacts with the Queensland energy sector and in particular the Queensland energy GOCs and publicly owned energy assets. It appears to risk infringing on the Queensland Government's sovereignty as shareholder of energy businesses, including the potential to provide for privatisation by stealth.

The Queensland Government is extremely disappointed with the Commonwealth Government's approach to developing this legislation. It is highly unconventional and contravenes standard practice for national energy law for the Commonwealth to pursue federal legislation to regulate the electricity sector without attempting to work with states and territories through the COAG Energy Council.

If you would like to discuss any matters in the submission in more detail or have any questions, please contact Ms Kathie Standen, A/ Deputy Director-General, Energy Division, Department of Natural Resources, Mines and Energy who will be pleased to assist you and can be contacted on [redacted]

Yours sincerely

Dr Anthony Lynham MP
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