Law Council
OF AUSTRALIA
Business Law Section

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Dear Structural Reform Group

Electricity price monitoring and response draft legislation

1. The Competition & Consumer Committee of the Business Law Section of the Law Council of Australia (the **Committee**) appreciates the opportunity to comment on the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019* (**Bill**).

2. The Committee holds concerns about the Bill in its current form and details these issues below. The Committee does 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.

A Division 2 – Prohibited Conduct

Retail Pricing

3. Section 153E requires a retailer to make reasonable adjustments to the price of its offers if there is a substantial and sustained reduction in the cost of procuring energy. The Committee notes that since the drafting of the 2018 Bill of the same name, section 153E has been amended to exclude regulated standing offers in NSW, South East Queensland and South Australia but not Victoria. The Committee is of the view that this amendment is desirable and reflective of the subsequent changes to effectively re-regulate retail energy prices in 2019 by capping prices for customers not on market offers. The exception should be extended to Victorian regulated standing offers for consistency.

4. However the Committee is of the view that the residual application of Section 153E raises concerns. In effect, the combination of the prohibition in section 153E together with the exceptions for regulated price offers means that:

   a) retailers are permitted to price offers at the regulated price; but

   b) are required, if the offer is a market offer, to adjust that offer if there is a substantial and sustained decrease in procurement costs.

5. The Committee is concerned that this gives rise to two key issues:

   a) first, the definition of prohibited conduct set out in section 153E(1) is vague and subjective and does not reflect any established body of legal or economic principle; and

   b) secondly, the practical operation of section 153E(1) in addition to regulated price offers results in significant and potentially onerous regulation of prices otherwise set by competitive processes.

Definition of prohibited conduct – retail pricing is vague and subjective

6. Section 153E(1)(a) provides that a corporation contravenes this section if two elements are met:

a) the corporation offers to supply electricity or supplies electricity to small customers; and

b) the corporation fails to make reasonable adjustments to the price of those offers or to the price of those supplies to reflect sustained and substantial reductions in its underlying cost of procuring electricity.

7. The Committee considers that the key definitional element in this definition – that a corporation has failed to 'make reasonable adjustments' to reflect sustained and substantial reductions in its underlying costs of procuring electricity – is vague and subjective and is also 'unsymmetrical' in its design. In the Committee's view, the notion of 'reasonable adjustments' in this context is not a concept for which there is any established body of economic principle or legal precedent that would provide meaningful guidance as to the application of this concept.

8. As a general proposition, legislation prohibiting conduct should define that conduct in a manner that allows corporations subject to it to determine, with reasonable certainty, conduct that is or is not likely to be prohibited by the legislation. The current definition used does not meet that standard and raises real questions of fairness and equity as a result.

9. In addition, the concept of 'reasonable adjustments' is not a definition that connotes any settled economic or legal meaning. It is entirely subjective. Typically, where legislation imposes price controls, there is both a set of substantive principles enacted that must be applied to determine the relevant price and a set of procedural decision making processes which include procedures for examining relevant evidence and determination by specialist economic bodies. An example of this is the accrual building block methodology as applied to regulated gas and electricity network businesses in Australia. As a result, electricity retailers currently setting prices in response to supply and demand conditions in the market (which are critical to the long term functioning of markets), will instead have to make retail pricing decisions having regard to the vague and subjective 'reasonable adjustments' standard.

10. The Committee also notes that the proposed section 153E(1) is not symmetrical in its proposed operation, in that it only mandates cost reductions if the underlying cost of procuring electricity has reduced. The design of the prohibition thereby proceeds on the assumption that *the starting price for each electricity retail at the time of commencement will be cost-reflective*. The Committee is not aware that any empirical study has been undertaken to determine if this is likely to be the case. For example, it could be the case that electricity retailers have recently (partly) absorbed increases in wholesale electricity prices and some of the network charges. When these input prices return to more normal levels, this provision, as drafted, would make it an offence not to reduce the retail prices. That would be unsymmetrical. Arguably, the appropriate and efficient outcome would be not to pass on that particular input cost reduction. If this rule stands, retailers will be less likely in future to absorb any input cost increases. Instead, as a result of this clause, they would immediately pass on all input cost increases. The effect of this prohibition would be to expose retail customers to volatility in wholesale electricity costs. The Committee notes that this would surely not be the intended outcome of enacting this provision.

Section 153E(1) results in significant and potentially onerous regulation

11. The Committee observes that significant reforms in the form of the introduction of regulated standing offers have been established since the 2018 Bill was drafted (which introduced the concept of 'Prohibited Conduct – Retail Pricing'). This concept, on its face, was drafted in order to provide material and direct price protection for potentially vulnerable small customers.

12. The Committee is therefore concerned about the retention of section 153E(1) in the Bill, because it considers that the section is not warranted or necessary to achieve the underlying policy objectives, particularly in light of the introduction of regulated standing offers. As noted above, energy retailers will face significant difficulties in determining how to comply with an inherently vague and subjective additional regulatory intervention in retail electricity pricing that is otherwise determined by competitive forces of supply and demand. In the Committee's view, there is significant potential for section 153E(1) to simply add complexity and cost to the operation of the retail electricity market with little confidence that it will result in net benefits to small customers. For example, the Australian Competition & Consumer Commission's (**Commission**) electricity report highlighted the importance of competition in the retail sector, which operates to maintain

downward pressure on costs and see the benefits of cost reductions passed through to consumers. The proposed prohibition in section 153E(1) creates a significant regulatory obligation which will make it more difficult for Tier 2 and Tier 3 retailers to enter electricity markets and grow in the face of competition from larger incumbents. Ironically, the Commission also reported on the importance of innovation, yet the proposed prohibition will demand much more uniformity in retail pricing methodologies. The idea that retailers will instead differentiate through non-price innovation, when each is required to price their retail products in a similar way, is optimistic. There is a risk that differentiation at the retail level will be driven by little more than the depths of a retailer's pockets. The Committee submits that consumers will realise greater benefits from reforms that encourage, rather than impede, competition and innovation in electricity retail markets.

13. In the Committee's view, consideration should be given to deleting section 153(1) in light of the introduction of regulated retail offers, or to delay consideration of doing so for a period to determine whether there is evidence of that regulatory intervention not having had an adequate impact on pricing to small customers.

Other forms of prohibited conduct

14. The Committee considers that many of the issues relating to the retail pricing prohibition also arise with respect to the other forms of prohibited conduct set out in sections 153E, 153F and 153G, namely:

    a) the definitions of prohibited conduct contain vague and subjective concepts that are difficult for corporations to measure their conduct against; and

    b) the remedy of divestment for prohibited conduct in the wholesale electricity market is unlikely to be a proportionate or effective remedy.

15. Without being exhaustive, and by way of example:

    a) **Electricity financial contract liquidity:** section 153F is restricted to situations where a corporation acts in the proscribed manner with the purpose of substantially lessening competition. However, the Committee considers it problematic to prohibit corporations from not offering a contract or from imposing limits on the contracts it offers, particularly when the legislation does not specify to whom electricity financial contracts must be offered. Further, the legislation does not recognise the many legitimate factors that could limit a corporation's capacity to offer contracts or upon which terms a corporation might offer those contracts (including a corporation's well established right to trade with whomever it chooses, subject to existing competition laws).

    The wording in section 153F(b)(iii) provides another example of the uncertain scope of the prohibited conduct provisions. It applies where a corporation offers to enter into electricity financial contracts in a way that has, or on terms that have, the effect or likely effect of preventing, limiting or restricting acceptance of those offers. Questions may arise, including, (i) acceptance by whom? and (ii) is the condition established if a single offeree does not accept an offer, even if that non-acceptance is unreasonable?

    The intended target for the prohibition in section 153F appears to be large 'gentailers', but it is not difficult to see its possible use to prosecute small electricity retailers, given the subjectivity and lack of precision of the drafting. This would not be a desirable outcome, as it could make retailing less competitive than would otherwise be the case. Further, as the conduct is already covered by section 46 of the Competition and Consumer Act 2010 (Cth) (**CCA**), its inclusion can only be to impose the remedies outlined in the Bill, many of which are disproportionate to the harm as outlined below. The Committee submits that the remedies currently contained within the CCA should be sufficient to address any anticompetitive harm.

    b) **Electricity spot market (basic case and aggravated case):** sections 153G and 153H apply where a corporation acts or fails to act in the proscribed manner 'for the purpose of

distorting or manipulating prices in [an] electricity spot market'. However, the Bill does not define what it means by 'distorting or manipulating'.

In economic terms, distorting usually means that conduct has moved prices relative to some perfectly competitive ideal. If this is the intention, the prohibition may have the unintended consequence of capturing many bids into the NEM that are placed with strategic objectives in mind. Such bids are not of themselves anti-competitive: some corporations might bid their marginal costs (but will expect to receive a higher price necessary to recover their fixed costs), whilst others might bid very high prices expecting to be dispatched infrequently, but receiving those high prices when they are dispatched.

The presence of government policies, in particular the Renewable Energy Target, in itself causes distortions to wholesale pricing (depending on how broadly distortion is defined). If, for example, electricity generators respond to the intended incentives of the Government's policies, there is the potential for them to be engaging in prohibited conduct, given the breadth and imprecision of these provisions.

The distinction between the "base case" and the "aggravated case" (the former applying to actions which are fraudulent, dishonest or in bad faith *or* are for the purpose of distorting or manipulating price and the latter to actions which contain both elements) is also unclear in practice.

B Division 3 – Public Warning Notices

16. The Committee does not consider it appropriate to introduce a power to issue public warning notices in the manner contemplated by Division 3 of the Bill.

"Reasonable belief" is an unworkable threshold for public warning notices

17. The test for whether the Commission can issue a draft or final public warning notice relies on the Commission forming a "reasonable belief" that each of the following matters arise:

    a) the corporation has engaged (or is engaging) in prohibited conduct;

    b) one or more persons has suffered, or is likely to suffer, detriment as a result of the prohibited conduct; and

    c) it is in the public interest to issue the notice.

18. In relation to the first criterion, the basis upon which the Commission would be able to form a reasonable belief is unclear, given the uncertain and imprecise nature of the prohibited conduct provisions as discussed above. For example:

    a) In the case of section 153E (retail pricing), on what basis is the Commission to form a "reasonable belief" that a corporation is failing (or has failed) to make "reasonable adjustments" to its pricing offers? As noted above, while the Committee acknowledges the attempts to provide guidance in the Explanatory Memorandum, the Bill itself offers no specific guidance on what constitutes a "reasonable adjustment", or the basis upon which a reduction in the "underlying cost of procuring electricity" is to be measured.

    b) In the case of section 153F (financial contracts), on what basis is the Commission to form a "reasonable belief" that the corporation has engaged in the relevant conduct for the purpose of substantially lessening competition in any electricity market? The determination of a corporation's subjective purpose is a complex question that can only be answered by examination of all the relevant circumstances.[1] In the Committee's view, the application of section 153J does nothing to simplify this assessment, but contains another gloss on the legislation.

    c) In the case of section 153G or section 153H (electricity spot markets), as with section 153F, on what basis is the Commission to form a "reasonable belief" that a corporation's

[1] See, e.g., *Universal Music Australia Pty Ltd v ACCC* (2003) 131 FCR 529; *ACCC v Cement Australia* [2013] FCA 909

conduct was fraudulent, dishonest or in bad faith, or that its purpose was for the distortion or manipulation of prices?

19. In the Committee's view, the complexity of the factual and legal questions that must be answered before a corporation's liability for prohibited conduct under the Bill can be ascertained render it inappropriate for the prohibitions in Division 2 to be subject to the ability to issue a public warning notice in the manner contemplated by Division 3.

Public warning notices are not appropriate for the matters relevant to prohibited conduct

20. The Committee notes that the Commission does not have the power to issue public warning notices in respect of any provision in Part IV of the CCA, which are provisions in the CCA which rely on many of the same concepts as the prohibited conduct.

21. To the contrary, the only existing powers for the Commission to issue a public warning notice are confined to provisions within the Australian Consumer Law (**ACL**) and Part IVB of the CCA (Industry Codes).[2] The limited utility of public warning notices and the reticence of the Commission to rely on its existing powers is evidenced by the fact that the Commission has published only five such notices in the past eight years.[3]

22. Further to this, the Committee considers that the object of a public warning notice power, and the context in which a public warning notice may be an appropriate remedy, are quite specific and limited. As the *Public Warning Notices Guide* developed by the State and Commonwealth authorities responsible for the enforcement of the ACL points out,[4] a public warning notice provides ACL regulators "*with a compliance tool that may be used to prevent or reduce the opportunity for consumer detriment by alerting consumers to the alleged conduct.*"

23. The *Public Warning Notices Guide* further states:

> *Issuing a public warning notice to alert the public to conduct which may contravene the ACL may be appropriate when there is* ***an imminent or ongoing risk of consumer detriment****. Relevant to a decision to exercise the public warning notice power is the* ***balance between the likely impact on the relevant person or business, against the known or likely risk of consumer detriment and the need to act in a timely manner****.*[5]

24. In the context of each form of prohibited conduct in the Bill, it is highly unlikely that a Public Warning Notice could substantially mitigate any risk of consumer detriment, for the following reasons:

    a) In the case of section 153E, the prohibited conduct involves a failure to pass on cost reductions to ***existing*** small customers. Even if the Commission *could* form a reasonable belief about the existence of this conduct (which is doubtful), a public warning notice would not prevent any potential loss for the corporation's existing small customers from that failure to pass on cost reductions.

    b) In the case of each of sections 153F, 153G and 153H, given the nature of the electricity financial contracting and electricity spot markets respectively, it appears highly unlikely that a detriment identified by the Commission in relation to these forms of conduct could be mitigated by the release of a public warning notice.

25. Given the very real prospect that a public warning notice issued against a corporation for any form of the prohibited conduct would have adverse consequences for that corporation's business and commercial reputation, the Committee considers it very unlikely that the balancing exercise referred to in the *Public Warning Notices Guide* could reasonably lead to a decision that publication of a public warning notice was an appropriate or in the public interest. As a consequence, the Committee does not support retaining these powers in the Bill.

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[2] See ACL section 223 and CCA section 51ADA.
[3] See http://registers.accc.gov.au/content/index.phtml/itemId/943316.
[4] *Public Warning Notices Guide* (ACL Regulators, 2012). Available at: https://www.commerce.wa.gov.au/sites/default/files/atoms/files/aclpublicwarningnoticesguide.pdf
[5] Ibid, at [2], p 5

Suggested amendments if public warning notice powers are to be introduced

26. In the event that the Government determines that it is necessary and appropriate for these powers to be introduced, the Committee recommends that the Bill be amended so that:

    a) the threshold for issuing a draft public warning notice under section 153L and a public warning notice under section 153M is that the Commission has "reasonable grounds to believe" that the conditions set out in those sections are satisfied;

    b) the substantive provision of section 153L makes it clear that the notice issued to the corporate is a draft (currently, this is only referred to in the section heading);

    c) the Commission is required to consider any representations made by the corporation as contemplated by section 153L(2)(d)(i) prior to issuing a public warning notice under section 153M; and

    d) the Commission is required to provide the corporation with the final public warning notice at least 7 days prior to issuing a public warning notice under section 153M.

C Division 4 – Procedure before Treasurer's Order

27. The Committee considers that its comments in relation to the requirement for the Commission to form a "reasonable belief" in relation to the decision to issue a draft or final public warning notice pursuant to Division 3 of the Bill are equally applicable to the requirements for the Commission to make the same assessment as part of the procedures relating to prohibited conduct notices, specified in sections 153P and 153R of Division 4.

Timeframes are too short

28. From a procedural perspective, the Committee has serious concerns regarding the process by which the prohibited conduct notice provisions in Division 4 of the Bill are structured.

29. Most importantly, the stated statutory timeframe of 45 days in section 153P(3) is a very short period for a corporation to respond to the matters set out in a prohibited conduct notice. The matters contemplated by such a notice are likely to require a corporation to closely examine its commercial operations and gather detailed information to be able to respond to the Commission's contentions and recommendations, as is contemplated in section 153P(2)(f).

30. By way of example, it is highly likely that a corporation will need to undertake an extensive internal information gathering exercise and seek expert advice in order to demonstrate the corporation's:

    a) underlying cost of procuring electricity (if the prohibited conduct is that described in section 153E);

    b) electricity financial contracting history and decision-making processes, as well as the purposes for which it has acted or failed to act (if the prohibited conduct is that described in section 153F); and

    c) evidence of the manner in which it has bid electricity generation assets for dispatch into an electricity spot market, as well as the circumstances in which it has acted or failed to act (if the prohibited conduct is that described in sections 153G or 153H).

31. As such, the time period of 45 days may be significantly shorter than appropriate for a corporation to gather the appropriate materials and develop a detailed response to the allegations and recommendations set out in a prohibited conduct notice.

Procedural fairness issues

32. As with the proposed public warning notice provisions, it is unclear to what extent (if any) the Commission must have regard to representations provided by a corporation in response to a prohibited conduct notice. There is no statutory requirement for the Commission to consider the representations provided by the corporation.

33. Further, in accordance with section 153S(1), the threshold for the Commission to make a prohibited conduct recommendation is identical to the test for the Commission to issue a public warning notice – being the Commission forming a "reasonable belief" – which gives rise to the same concerns identified by the Committee in section B in relation to public warning notices. In addition, the Commission must have a reasonable belief that the order would be a 'proportionate means' to prevent the conduct. Again, this concept is vague and unknown in competition law.

34. The Committee is particularly concerned that sections 153S(3) and 153S(5) specifically permit the Commission to provide different recommendations, or identify a different corporation, in a prohibited conduct recommendation to those specified to the corporation in the corresponding prohibited conduct notice under section 153P. In the Committee's view, procedural fairness cannot be achieved in circumstances where:

    a) the Commission can provide the Treasurer with a recommendation that includes recommendations about which the corporation has not had any opportunity to respond; and

    b) where the prohibited conduct recommendation includes a recommendation for a divestiture order (but the prohibited conduct notice did not), the corporation has not had any opportunity to respond to the reasons for which the Commission considers the requirements in relation to divestiture orders (as set out in section 153S(2)(e)(ii)) are met.

35. In addition, the Commission is not currently required to provide a copy of any prohibited conduct recommendation to the corporation to which it applies. As a procedural matter, particularly given the Commission's ability to vary or revoke a prohibited conduct recommendation, a copy of the recommendation should be provided to the corporation. Further, a procedure should be implemented to allow the corporation to respond to any matter contained in the recommendation that was not included in the prohibited conduct notice, prior to the prohibited conduct recommendation being provided to the Treasurer.

Suggested amendments to Division 4

36. In the event that the Government determines that it is appropriate for Division 5 to be retained, the Committee recommends that the Bill be amended so that:

    a) the timeframe in section 153P(3) be increased to 90 days;

    b) the threshold for issuing a prohibited conduct notice under section 153P and a prohibited conduct recommendation under section 153S is that the Commission has "reasonable grounds to believe" that the conditions set out in those sections are satisfied;

    c) the Commission is required to provide a copy of any prohibited conduct recommendation to the corporation prior to it being provided to the Treasurer, and the corporation is able to make representations to the Commission in relation to any recommendation not set out in the prohibited conduct notice within 90 days of receipt of the recommendation;

    d) the Commission is required to consider any representations made by the corporation as contemplated by section 153P(2(f) prior to giving the Treasurer a prohibited conduct recommendation under section 153S. This requirement should also apply to any representations made by the corporation in relation to any recommendation not set out in the prohibited conduct notice (as per the Committee's suggested amendment above).

D Division 5 – Treasurer's Orders

37. The provisions in Division 5 of the Bill are concerned with Treasurer's Orders; that is, orders that the Treasurer can make upon receipt of a prohibited conduct recommendation from the Commission.

38. Broadly, a Treasurer's Order may require a corporation (which, in practical terms, must either be an electricity generator or retailer) to make offers to enter into electricity financial contracts including the kinds of offers, the manner in which the corporation must make those offers, the kind

of entities to which those offers must be made and the period during which the body corporate must make those offers.

39. It is proposed that Treasurer's Order can be made by the Treasurer on the recommendation of the Commission. The role of the courts would be limited to:

    a) enforcement of a Treasurer's Order (if it is not obeyed); and

    b) judicial review of decision makers.

40. The Committee is concerned that these provisions are unlikely to be workable in practice or to lead to net benefits to consumers. It is implicit in the design of this remedy that the Treasurer will be capable of intervening to adjust contractual rights and obligations between sophisticated market participants in a manner that will lead to a more efficient allocation of resources than would occur through the workings of a competitive market. Typically, market interventions of this kind only occur if there is demonstrated risk of market failure or a requirement to regulate monopoly infrastructure. In these cases, an appropriate economic regulatory regime is typically designed featuring clear principles for establishing proxies for efficient market outcomes and an expert economic regulator, utilised to oversee the application of the chosen regime.

41. In contrast, the powers given to the Treasurer in Division 5 of the Bill are novel and unique to the extent that they permit and empower direct intervention between counterparties in a competitive market which is subject to ongoing dynamic interaction between market participants. In the Committee's view, the challenge in practical terms in a Treasurer's Order being designed and implemented in 'real time' to adjust contractual outcomes in a manner that would be likely to result in more efficient and therefore better outcomes for electricity consumers should not be underestimated. Indeed, the Commission has a long standing policy against acceptance of so called 'behavioural undertakings' (which seek to regulate conduct of this kind as a solution to market power problems) precisely because of the great difficulty in designing behavioural solutions that are likely to reliably mitigate market power for the benefit of consumers without risk of causing more harm than good.

42. Should the powers in Division 5 be retained, the Committee notes that the Bill does not contain any mechanism by which a Treasurer's Order can be reviewed on its merits. The Committee is strongly of the view that if the Treasurer is given the power to order divestiture, there should be a right of merits review to the Australian Competition Tribunal.

E. Division 6 – Electricity Divestiture Orders

43. Broadly, section 153ZA provides that the Treasurer may apply to the Federal Court for an order to dispose of interests in securities or assets if a Court has found that a corporation has engaged in conduct prohibited under section 153H (electricity spot market aggravated case).

44. The Committee notes that since the first consultations on this proposed remedy, it has been, first, limited in scope to section 153H and, secondly, required an application to be made to the Federal Court for an order for divestment (rather than this being a power exercisable by the Treasurer). These are sensible and appropriate changes which are welcomed by the Committee.

45. However, the Committee remains of the view that a specific divestment power is inappropriate to include in circumstances in which:

    a) the remedy is predicated on contravention of a new, novel and untested legal standard (ie the prohibition set out in section 153H);

    b) the remedy is available for contravention of a behavioural standard without any finding required that the behaviour arises from a market power issue linked to market structure (divestment conceptually being a remedy intended to address structural concerns in markets); and

    c) where there is no equivalent remedy in the CCA for behavioural contraventions (for example, divestiture is only a remedy under the CCA for contraventions of the section 50

prohibition of shares or assets that have the likely effect of substantially lessening competition, and is not available for contraventions of the section 46 prohibition on misuse of market power).

46. For these reasons, the Committee considers that the divestment remedy is not an appropriately targeted remedy for the harm it is seeking to address, creates significant uncertainty in relation to its application and creates a significant inconsistency with the wider legislative regime for the regulation of market power under Australian competition law.

Please contact [redacted], Chair of the Competition and Consumer Committee [redacted] in the first instance, if you require further information or clarification.

Yours sincerely

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