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8 November 2018

Consultation paper: Electricity price monitoring and response legislative framework

AGL Energy Limited (**AGL**) welcomes the opportunity to make a submission in response to Treasury's Consultation Paper titled *Electricity price monitoring and response legislative framework (October 2018)* (**Consultation Paper**).

AGL recognises the impact that sharp increases in energy prices are having on Australian consumers and businesses, as well as concerns about energy security and environmental sustainability. AGL understands and accepts the level of concern expressed in the Australian Competition and Consumer Commission's (**ACCC**) Retail Electricity Pricing Inquiry Final Report (June 2018) (**Final Report**) in respect of energy prices and the lack of transparency and comparability of energy offers faced by consumers. AGL agrees with many of the recommendations made by the ACCC in the Final Report, and endorses the need for reform of how energy products are marketed and sold, to move away from the current practices that do not give customers sufficient transparency and comparability.

AGL and other industry participants have been working with regulators to find a better way to make offers transparent and comparable. AGL will actively support initiatives designed to move the industry quickly towards enhanced transparency and comparability of energy offers, such as the initiative to establish a voluntary comparison rate for retail electricity prices, which was announced by the Minister for Energy following the roundtable with energy retailers on 7 November 2018.[1] AGL has also made unilateral steps to address some of these affordability concerns, and a list of these initiatives is attached at Annexure A.

Policy certainty is key to encouraging further generation supply investments, and this investment will place downward pressure on electricity prices. AGL notes in this context that vertically integrated retailers have been the predominant investors in new supply for the last 10 years. AGL has committed to five major power generation projects over the past year, totalling 1200MW of new capacity, which will put further downward pressure on prices.

However, the legislative framework that is proposed in the Consultation Paper presents a significant risk to investment in the energy market. The proposed framework outlines legislative provisions that are unnecessary, uncertain in their operation and impose extremely interventionist and disproportionate consequences, with vertically integrated retailers likely to be the most significantly impacted by the threat of divestment. AGL opposes the proposed legislative framework on the basis that:

- the new prohibitions are unnecessary, uncertain and will have unintended consequences that are against the public interest;
- the need for a 'default price' and the manner in which it would be used to regulate retailer pricing decisions is currently the subject of debate and consultation at both the Council of Australian Governments' (**CoAG**) and the AEMC. The provisions outlined in the Consultation Paper appear likely

[1] Media Release, The Hon Angus Taylor MP – Minister for Energy, "Comparison rate to reduce confusion" (7 November 2018).

to either duplicate the introduction of a default tariff, amend or extend the manner in which a default price will operate or introduce a *de facto* form of price regulation administered by the ACCC. AGL's view is that the CoAG and AEMC processes are the appropriate forums for debating retail price regulation and the Commonwealth should not seek to duplicate these processes or alter any part of the agreed outcome through a separate legislative framework;

- the new remedies and responses are disproportionate, lack procedural fairness and will deter investment. In particular, AGL opposes the proposed divestiture remedy in the strongest possible terms. Providing the Treasurer with the ability to exercise such an interventionist power through an administrative process will distort the proper functioning of the market, particularly given the apparent lack of procedural fairness afforded in the process; and
- the case for the new remedies has not been effectively made. Recent comprehensive and rigorous reviews of the energy sector have not identified any need for remedies of this kind. In fact, credible parties such as the ACCC have noted that remedies of this nature are not justified.

If you would like to discuss AGL's submission, please contact me on egriggs@agl.com.au or 03 8633 6077.

Yours sincerely,

Beth Griggs
General Manager - Competition Regulation & Strategy

1. Executive summary

AGL welcomes the opportunity to make a submission in response to Treasury's Consultation Paper. The Consultation Paper follows the Final Report.

The Consultation Paper outlines a framework for amending the *Competition and Consumer Act 2010* (Cth) (**CCA**) to introduce:

- three new prohibitions specific to the electricity sector that "broadly correspond" to the three main focusses of the ACCC's Final Report: (i) retail prices; (ii) wholesale bids and conduct; and (iii) contract market liquidity; and
- new "remedies and responses" for contravention of those prohibitions, ranging from a public warning notice to ordering divestiture of an energy businesses' assets (as a last resort).

AGL considers that the new prohibitions are unnecessary, uncertain and will have unintended consequences that are against the public interest (see Section 2 below).

- **Retail prices prohibition.** The need for a 'default price' and the manner in which it would be used to regulate retailer pricing decisions is currently the subject of debate and consultation at both the Council of Australian Governments' (**CoAG**) and the AEMC. It is not clear how or why the Commonwealth is proposing to introduce provisions that will either (i) duplicate the CoAG and AEMC processes on the introduction of a default tariff, (ii) amend or extend the manner in which a default price will operate to influence retail pricing (**Option A**) or (iii) introduce a *de facto* form of price regulation administered by the ACCC (**Option B**). Neither option does anything to address the identified concern – "consumers' confusion about retail electricity offers" and the difficulty of comparing offers. Rather, these options seek to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and in the long run, increase prices.

  AGL strongly supports the introduction of a reference point/comparison rate, which the CoAG has agreed to consider in December 2018 and is participating in the initiative to establish a voluntary comparison rate for retail electricity prices, which was announced by the Minister for Energy following the roundtable with energy retailers on 7 November 2018.[2] CoAG has also referred the Commonwealth's proposal for default price regulation to the AEMC for advice. At a minimum, consideration of default price regulation should be deferred until that advice is received. AGL's view is that the CoAG and AEMC processes are the appropriate forum to debate issues relevant to retail price regulation.
- **Bidding and liquidity prohibitions.** The necessary premise of the liquidity proposal is that vertically integrated retailers are withholding contracts from their non-vertically integrated retail competitors. There is no evidence that this is the case, nor evidence to support the need for the proposed prohibitions concerning wholesale bidding. The proposed remedy to the liquidity prohibition – an order by the Treasurer to make contracts available – would have unintended and potentially punitive consequences, including limiting the ability of vertically integrated retailers to efficiently manage pool price with their own generation.

  The prohibition and remedy will not address the root causes of high pool prices and lack of hedge contract liquidity, which are structural. There is no evidence that either vertical integration or levels of concentration in the market were in any way associated with high prices or reduced liquidity; indeed, economic advisors, Frontier Economics and NERA Economic Consulting, have drawn the opposite conclusion.

[2] Media Release, The Hon Angus Taylor MP – Minister for Energy, "Comparison rate to reduce confusion" (7 November 2018).

- **No "gap" in existing laws and regulations**. The existing provisions of the CCA (including the Australian Consumer Law (**ACL**)) provide an effective legal framework for regulating the behaviour of market participants. The scope of the misuse of market power prohibition (CCA section 46) has recently been expanded to cover conduct causing anti-competitive "effects", which remains untested. "Good faith" bidding rules introduced into the National Electricity Rules in 2016 on their face adequately address concerns regarding fraudulent, dishonest or bad faith wholesale bids, and the AER has not commenced enforcement proceedings under these amended rules yet.

AGL considers that the new remedies and responses are disproportionate, lack procedural fairness and will deter investment (see Section 3 below).

- **The enforcement process for the Treasurer-ordered "remedies"[3] lacks procedural fairness.** This is particularly the case given the serious consequences of the proposed remedies. In making its recommendation to the Treasurer, the ACCC is only required to "identify misconduct" and does not need to set out the material facts or evidence that they rely upon nor meet the evidentiary standard that would be required by a court. The respondent company has an extremely short (30 day) period to respond to the ACCC, and appears to have no opportunity to make submissions to the Treasurer or respond to the ACCC's recommendation to the Treasurer. Merits and judicial review of the Treasurer's determination may be available, but is likely to be limited in scope and application.
- **Divestiture is an extreme remedy, unsupported by the ACCC and likely to have unintended consequences - AGL opposes the proposed divestiture remedy in the strongest possible terms.** Divestiture is an extreme remedy that is largely unknown in Australian legal regimes. Divestiture of assets is unlikely to address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity).

  Vertically integrated retailers have been the predominant investors in new supply for the last 10 years. Vertically integrated retailers are also the market participants most impacted by the threat the exercise of a divestment power that has no foundation in a court determining a contravention of the law. Divestiture of retail assets may be against the interests of the consumers who have elected to enter into contracts with the targeted business. Divestiture of generation assets for a vertically integrated retailer at best increases its own costs of supplying its customers, and at worst presents the retailer with pool price risks that it cannot manage. Divestiture of listed companies' assets would be against the interests of shareholders.

  Investors will also inevitably take the risk of forced divestiture into account, potentially raising the cost of capital for investments made by energy companies and adding a new source of risk for equity and debt financiers. The impact will be to reduce available capital in the market for energy investments, and potentially lead to an unwarranted destruction of shareholder value. The cost of debt finance may also rise as lenders to energy companies identify a substantial risk to asset values, placing upward pressure on the cost of funds for new investments.

  Rather than addressing a demonstrated market failure, given the operational and economic reality of how the NEM functions, the divestiture power is likely to be punitive. It will not address concerns raised with the current operation of the electricity market. Instead, it is likely to increase risks and costs borne by market participants, due to rising costs of capital, all of which is likely to exacerbate, rather than ameliorate those issues.

[3] Note, it is not conceded that any of the proposed Treasurer-ordered remedies are properly characterised as remedies, and are not more properly characterised as penalties. The word "remedy" is adopted in this submission for the purpose of consistency with the terminology used in Consultation Paper.

2. New prohibitions are unnecessary and uncertain

AGL does not believe that there are any deficiencies in the current legislative framework regulating the electricity sector that warrant the intervention contemplated in the Consultation Paper. AGL is firmly of the view that the proposed prohibitions are unnecessary, uncertain and will have unintended consequences that are against the public interest and that no credible case for these powers has been made out.

- **Retail prices prohibition.** The implementation and enforcement of a default price, as distinguished from the establishment of a market wide reference price, is the subject of intense political debate between the Commonwealth and the states. The issue has been referred to the AEMC for consideration.[4] In this context, it is not clear how or why the Commonwealth is proposing to introduce provisions that will either (i) duplicate the CoAG and AEMC processes on the introduction of a default tariff, (ii) amend or extend the manner in which a default price will operate to influence retail pricing (**Option A**) or (iii) introduce a *de facto* form of price regulation administered by the ACCC (**Option B**).

  Neither option does anything to address the identified concern – "consumers' confusion about retail electricity offers" and the difficulty of comparing offers. Rather, these options seek to replace consumer choice with market regulation, which is instead likely to distort incentives, increase regulatory burden, reduce competition and in the long run, increase prices.

- **Bidding and liquidity prohibitions.** The necessary premise of the liquidity proposal is that vertically integrated retailers are withholding contracts from their non-vertically integrated retail competitors. Where AGL has capacity in its portfolio to sell to third parties it does so and AGL is currently a provider of contracts to a number of smaller competitors. There is no evidence to support the need for the proposed prohibitions concerning wholesale bidding and contract liquidity.

  In its Final Report, the ACCC set out no evidence that either vertical integration or levels of concentration in the market were in any way associated with high prices or reduced liquidity. AGL provided the ACCC with two economic studies that provided analysis to the contrary, which the ACCC did not substantively address. Frontier Economics (August 2017) concluded that:[5]

  - Vertically integrated generators behave more competitively on average than when they were operating as stand-alone generators. Vertically integrated generators were found to be bidding 4% to 6% more capacity at competitive prices. That result is statistically significant.
  - There is no statistical evidence that the trend towards vertical integration across the NEM has contributed to generators bidding at higher prices. Further, there is no compelling statistically significant evidence that horizontal integration has caused generators to bid more capacity at higher prices.

  NERA Economic Consulting (November 2017) concluded that:[6]

  - In electricity markets that lack the conditions required to foster liquid contract markets, vertical integration is an efficient competitive response to risk, which reduces the cost of risk management. Vertical integration therefore reduces costs throughout the market and puts downward pressure on prices to consumers.
  - Increased vertical integration does not necessarily reduce liquidity in contract markets. The combination of circumstances that would prevent some generators and retailers from gaining access to hedging contracts is rare, and does not apply in Australia. Vertical integration by itself

[4] CoAG Energy Council, 20th Meeting Communique (26 October 2018).
[5] Frontier Economics, "*Effects of vertical integration on capacity bidding behaviour*" (August 2017), pages 2-3.
[6] NERA Economic Consulting, "*International Experience of Vertical Integration in the Electricity Sector: A Report for AGL Energy Ltd*" (22 November 2017), pages 2-3.

does not provide grounds for concern in this respect, because competing firms have an incentive to trade contracts even if they are vertically integrated.

The remedy to the proposed liquidity prohibition – an order by the Treasurer to make contracts available – would have unintended and potentially punitive consequences (see Section 3.2). Vertically integrated retailers manage their wholesale portfolio firstly to manage the risk of pool price exposure for their retail load. The risk that a vertically integrated business may be effectively deprived of the "use" of its own generation as a risk management tool for its retail business will impose higher risks and therefore costs on that business.

The prohibition and remedy will not address the root causes of high pool prices and lack of hedge contract liquidity, which are structural and include the retiring of aging thermal generation, increasing gas and coal prices, and the limited ability of renewables to offer hedge contracts. In its Final Report, the ACCC identified the causes of increased wholesale prices as:[7]

- a shift in the mix of generators supplying electricity and setting wholesale prices;
- changes in the costs of generation, in particular increases in the costs of gas and black coal; and
- the current market structure.

(The ACCC Final Report identified other factors contributing to increased *retail* prices more generally – including excessive increases in network costs, overly-generous solar feed-in tariff schemes, entry of low-emissions generation that cannot be dispatched to meet demand under the Renewable Energy Target, the exit of large coal-fired plants and increases in gas costs driven by LNG exports and government moratoria on onshore gas development).[8]

Further, the Energy Security Board (**ESB**) consulted on the ACCC's Final Report recommendations that would require (i) reporting of all over-the-counter (**OTC**) trades and (ii) large, vertically integrated retailers to offer hedge contracts each day in South Australia (market liquidity obligation or **MLO**). These recommendations are intended to increase contract market transparency and liquidity. AGL provided a submission in support of both recommendations. AGL supports cost-efficient initiatives to improve transparency and reduce information asymmetries provided that the compliance cost to industry are minimalised and confidential information is robustly protected. AGL positively supports market making mechanisms to improve market liquidity.

- **No "gap" in existing laws and regulations**. The Consultation Paper contains, in support of the proposed obligations and remedies, hypothetical examples of the events and circumstances which the paper indicates would breach the proposed obligations and give rise to the need for the proposed remedies. In every case the existing provisions of the CCA (including the ACL) provide an effective legal framework for regulating the behaviour of market participants.

  AGL notes that the scope of the misuse of market power prohibition (CCA section 46) has recently been significantly broadened to cover conduct that has the effect of substantially lessening competition (the "effects test"). The scope and nature of the prohibition in section 46 was comprehensively considered by the Competition Policy Review led by Professor Ian Harper (**Harper Review**). AGL understands that there would be a real risk that an "unreasonable refusal" by a major vertically integrated retailer to offer contracts to a rival would contravene the CCA section 46. As the Harper Review amendments to section 46 remain untested in the Federal Court, there is currently no basis to conclude that the law is deficient in some respect and unable to address concerns about misuse of market power in energy markets. Further, the Consultation Paper has not provided any clear economic or policy rationale for why conduct

[7] ACCC, Final Report, page 54.
[8] ACCC, Final Report, page iv - v.

that would not otherwise be prohibited under section 46, should be captured under the proposed prohibitions.

Similarly, 2016 amendments to the National Electricity Rules to reform the "good faith" bidding rules on their face adequately address concerns regarding fraudulent, dishonest or bad faith wholesale bids. AGL notes that those rules were the subject of careful consideration and consultation by the AEMC. It is noteworthy that notwithstanding the public interest in ensuring the bidding rules for the National Electricity Market are enforced, the AER has not yet commenced proceedings to enforce these rules since the 2016 amendments.

Further, a key concern of the ACCC Final Report was misleading marketing in relation to energy pricing. Confusion and the inability to compare offers contribute to consumers paying more than they should. AGL agrees that marketing practices need to be reformed and supports the introduction of a comparison benchmark, with CoAG already agreeing on the need to develop a reference point/comparison rate against which all offers could be measured. Further, as discussed above, AGL is participating in the initiative to establish a voluntary comparison rate for retail electricity prices as announced by the Minister for Energy on 7 November.

Accordingly, there is no "gap" in the law that needs to be addressed by new prohibitions.

- **Potential for unintended consequences**. Finally, AGL urges caution and restraint in potentially amending the legal framework for the regulation of economic activity in the energy sector. The process of reform of major economic laws by the Commonwealth and CoAG has historically been undertaken in a careful and deliberative manner. For example, the Harper Review was subject to extensive and lengthy consultation and AGL considers a similar consultative process should be adopted for the proposed framework to ensure any reform is fit for purpose. This is precisely because economic laws can have profound and unintended consequences causing damage to the economy and to the public interest.

  AGL sets out its comments on the draft prohibitions below. AGL notes that it is difficult to comment fully on the draft prohibitions, given that the Consultation Paper does not clearly articulate the problems that these prohibitions seek to address, nor how the prohibitions will operate.

2.1. Retail prices prohibition

The purported aim of the proposed retail price prohibition is to *"target retailer conduct which takes unfair advantage of consumers' confusion around retail electricity offers and their difficulty in identifying and switching to better deals."* Yet Options A and B do nothing to reduce any consumer "confusion", nor to improve consumers' ability to compare retail electricity offers. Rather, both options seek to regulate business activities through heavy-handed and uncertain regulation of energy business' pricing decisions, potentially deterring competitive conduct. Both options suggest a form of retail price regulation.

Retail price deregulation has increased retail competition, bringing benefits to consumers (lower prices, more innovative products etc). *De facto* price re-regulation under Option A is highly likely to reduce competition, and diminish the benefits to consumers that competition brings. The implementation and enforcement of a default price, as distinguished from the establishment of a market wide reference price, is the subject of intense political debate between the Commonwealth and the states through CoAG. CoAG has recognised that the re-introduction of price regulation in electricity markets may have unintended consequences and has referred the Commonwealth's proposed default tariff to the AEMC. The CoAG Communique states:[9]

> *Ministers agreed on the need to develop a reference point/comparison rate against which all offers could be measured, for consideration at the December Council meeting. Western Australia, Victoria,*

[9] CoAG Energy Council, 20th Meeting Communique (26 October 2018).

Tasmania and the Northern Territory noted that this would not apply in their jurisdictions. Ministers also agreed that the AEMC undertake work on the impacts of the Commonwealth's proposed default tariff on competition issues and customer impacts including price for both standard and market customers in relevant jurisdictions.

AGL strongly supports the introduction of a reference point/comparison rate under the CoAG process and establishing a voluntary comparison rate for retail electricity prices as announced by the Minister for Energy on 7 November. At a minimum, consideration of default price regulation should be deferred pending the receipt of the advice of the AEMC. AGL's view is that the CoAG and AEMC processes are the appropriate forum for debating retail price regulation. In this context, it is not clear why the Commonwealth is proposing to introduce Option A or Option B outside of these processes, which could either duplicate the debate and work being undertaken through these processes, could amend or extend the manner in which any agreed default price will operate to influence retail pricing, or introduce a form of *de facto* price regulation under the administration of the ACCC.

The evolution of the NEM and retail price deregulation has been the subject of careful and cooperative deliberations between the States and the Commonwealth since at least 1996 and any abrogation of these conventions shaping the development of energy policy is likely to have unintended consequences adverse to the public interest

To the extent that there is concern that some businesses may take "unfair advantage" of their customers, AGL notes that the ACL prohibits unconscionable conduct (section 21), misleading or deceptive conduct and representations about goods or services (section 18 and section 29) and unfair contracting (sections 23-28) which carry substantial and recently increased penalties. Any further prohibition should not duplicate the ACL regime.

Option A

Option A proposes the following new prohibition:

An electricity retailer must not charge its small customers a price that is higher than the default market offer unless this is justified by a substantial difference in the terms and conditions of the offer.

The purpose and likely application of Option A is uncertain, for example, what is the "default market offer", who makes it and how is it calculated? For the purposes of responding to the Consultation Paper, AGL assumes that the "default market offer" price is determined by a regulator on the basis of some estimate of "efficient" costs. Under Option A, even where a company has legitimate or reasonable reasons to price above the default market offer, the associated legal uncertainty of the prohibition and consequent risks of "remedies and responses" (see section 3 below) would potentially deter them from doing so. Accordingly, Option A has the potential to have the effect of capping retail prices at the "default market offer".

AGL does not understand the basis for Option A given the current deliberation in respect of default pricing at CoAG. Option A appears likely to either duplicate any legislative or regulatory instrument following CoAG's decision in this respect, or it will amend or extend the application of the default price as determined by CoAG.

Option B

Option B proposes the following new "prohibition":

An electricity retailer must adjust the prices charged to its small customers to reflect sustained decreases in wholesale market costs.

AGL notes that it is unclear what Option B proposes, given that it is not expressed as a prohibition.

Option B appears to seek to mandate that retailers pass-through reductions in wholesale market cost to consumers in circumstances where an agreed default price has not been implemented (a "default market offer" is expressly mentioned in Option A, but is not referenced in Option B). AGL suggests that in circumstances where the introduction of regulated pricing has not been agreed by CoAG, the introduction of this provision would need to be carefully considered. This will be particularly true if CoAG agree to a reference point/comparison rate, which will allow consumers to meaningfully compare different offers.

AGL considers that competition, not a legal prohibition, is the appropriate mechanism to drive the pass-through of any cost reduction to consumers. In this context, electricity retail markets are already effectively competitive. Legal restrictions that mandate "competitive" conduct are unlikely to improve competitive outcomes, and indeed are more likely to distort incentives and deter competitive conduct and efficient investment. This is particularly the case given that any implementation of Option B would require clarity and certainty in relation to a number of complex economic and legal concepts. For example:

- How will wholesale market costs be measured? Will the relevant costs be specific to each retailer (actual costs) or the market overall (some form of market estimate)? How will the "cost" of a physical generation hedge be measured? How will differences between NEM regions be taken into account?

  Every retailer will incur a different wholesale cost. The wholesale energy costs incurred by a particular retailer is a combination of that retailer's spot market exposure and hedging costs (including any physical hedging). Retailers' wholesale energy costs differ materially based on their strategy for managing spot price exposure and risk appetite.

- What constitutes a "significant" decrease in wholesale market costs,[10] and over what period must it be "sustained"?

  The NEM spot price varies on a half hourly basis between –$1,000/MWh and $14,500/MWh, but a retailer's costs are determined by its hedge position which will be established months or years in advance.

- If a sustained decrease in wholesale market costs occurs, what price adjustment is required to avoid a contravention?

  Option B appears to assume a correlation between "wholesale energy costs" and consumer prices. However, other significant and variable retail electricity cost components include regulatory, network, retail and environmental costs. A reduction in wholesale energy costs may be offset by changes to other components of the retail cost stack.

AGL further anticipates material complexity in the interaction between Option B and the prescribed process and permitted timing for changes to standing offer rates under the National Electricity Retail Law (**NERL**).

2.2. Wholesale bids and conduct

The Consultation Paper proposes the following prohibition:

An electricity generator must not, when making a bid or offer to dispatch electricity, act fraudulently, dishonestly or in bad faith with the purpose of distorting or manipulating prices.

AGL considers that such a prohibition is unnecessary. There is no evidence that this type of manipulation presents a significant problem to the operation of the market. The following reviews of wholesale bidding have been conducted in the last 12 months, none of which identified this type of conduct as common, or of significant concern:

[10] The hypothetical example refers to a "significant" reduction, although the text of Option B does not.

- ACCC *Retail Electricity Pricing Inquiry – Final Report* (June 2018) – see page 96;[11]
- AER *Electricity wholesale performance monitoring – NSW electricity market advice* (December 2017) – see page 15;
- AER *Electricity wholesale performance monitoring – Hazelwood advice* (March 2018) – see page 17; and
- AEMC *Gaming in Rebidding Assessment (Grattan Response)* (September 2018) – see pages 35-36.

Further, the current regulatory framework deals comprehensively with this type of conduct, including under:

- the National Electricity Rules concerning (re)bidding of generation capacity, including the recent and as yet untested "Bidding in Good Faith" rule (introduced 1 July 2016);[12] and
- the CCA section 46 prohibition on the misuse of market power, including the recent and as yet untested "effects test" (introduced 6 November 2017).

AGL considers that, absent demonstrated and material deficiencies in the functioning of the generation bidding market or gap in the regulatory framework, further prohibitions should not be legislated.

The regulatory framework for the generation bidding market is well-developed and highly complex. The risk of unintended consequences is considerable, leading to inefficient market operation and negative flow on consequences for consumers and businesses. For this reason, the AEMC has an extensive process for considering and consulting on rule changes.[13]

Further, key regulators and energy experts **do not support** this new prohibition.

In a report commissioned by the ACCC as part of its Retail Electricity Price Inquiry, HoustonKemp cautioned against such actions:

> *However, under the energy-only market design it is difficult to distinguish between those high price events that are legitimately providing signals for investment in new capacity from those that might represent an exercise of market power. The fundamental characteristics of this type of market mean that the impact of any market power mitigation measures on legitimate price signals need to be considered carefully.*[14]

In its Final Report, the ACCC decided **not** to recommend the introduction of a market power mitigation rule, finding that discrete instances of market power being used to spike the price were not a key cause of higher wholesale prices.[15] The Final Report stated that "*clear instances of manipulation are not a major feature in the market today*."[16] The ACCC was also concerned that many of the market power mitigation rule options identified were likely to be a disincentive to new investment in generation by existing market participants.[17]

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[11] Other than the "unique circumstances in Queensland" which lead the Queensland government to issue a directive to Stanwell concerning its bidding to put downward pressure on wholesale prices – see ACCC Final Report, pages 92-93.
[12] https://www.aemc.gov.au/rule-changes/bidding-in-good-faith
[13] See https://www.aemc.gov.au/our-work/changing-energy-rules
[14] HoustonKemp Economists, International review of market power mitigation measures in electricity markets – A report for the Australian Competition and Consumer Commissions (May 2018), page 5.
[15] ACCC, Final Report, page 96.
[16] Ibid., page 96. While the ACCC suggested "*that such a rule is likely to be of increasing importance given the stronger links between the wholesale and contract markets envisioned under the draft design of the NEG [National Energy Guarantee]*", the Government is no longer pursuing that policy.
[17] ACCC, Final Report, page 96.

In its recent Gaming in Rebidding Final Report (September 2018), the AEMC found no evidence of material gaming in rebidding and concluded that "*the Commission does not consider the case for changing the rebidding arrangements has been made*".[18] The AEMC concluded:

> *To the limited extent that bidding and rebidding behaviour in the market are seen to be a problem … these issues related to industry structure should be addressed by policies that lower barriers to entry and promote efficient new investment … Changes to the rules concerning bidding in the NEM are unlikely to resolve issues in the wholesale market that are driven by industry structure*.[19]

2.3. Contract liquidity

The Consultation Paper proposes the following prohibition:

An electricity generator must not withhold, limit or restrict the availability of electricity financial contracts with the purpose of substantially lessening competition in an electricity market.

AGL supports greater transparency in the hedging contract market, however, the proposed prohibition does nothing to address this policy issue and is unnecessary.

The stated objective of the proposed prohibition[20] indicates that it is based on the incorrect premise that contract liquidity issues are a result of vertical integration in the market. Vertical integration provides a range of efficiencies to the NEM and there is no evidence that vertically integrated market participants restrict contracts or capacity to the market with the purpose of limiting competition.

Indeed, as described above, the analysis prepared by Frontier Economics and NERA Economic Consulting (and provided to the ACCC during its Retail Electricity Pricing Inquiry) found that liquidity has not suffered as a result of increased vertical integration. Indeed, concerning AGL's acquisition of Macquarie Generation specifically, Frontier Economics found that "*the transaction has resulted in an increase in liquidity … Removing AGL from the demand side of the hedge market has increased the ease with which competing retailers can acquire hedge contracts*".[21]

Any lack of liquidity in hedge contracts is not the result of behaviour by vertically integrated participants but rather the current conditions of the broader wholesale electricity market – such as the tightening of supply and demand, the increase in semi-scheduled and non-scheduled plant that do not generally supply firm contracts and policy uncertainty discouraging investment. All generators, whether vertically integrated or not, have strong financial incentives to offer hedge contracts to retailers.

The proposed remedy for this prohibition of the forced sale of financial contracts presents a very significant risk to generators operating in the market, and is likely to deter new entry and expansion (see Section 3.2).

As noted above, AGL understands that there would be a real risk that an "unreasonable refusal" by a major vertically integrated retailer to offer contracts to a rival for a proscribed purpose would contravene CCA section 46. Further, as noted above, the ESB consulted on the ACCC's Final Report recommendations intended to increase contract market transparency and liquidity. AGL provided a submission in support of both recommendations as discussed above.

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[18] AEMC, Gaming in Rebidding Final Report (September 2018), page (iii).
[19] AEMC, Gaming in Rebidding Final Report (September 2018), page 35.
[20] The Consultation Paper states that the objective is "*to target conduct whereby a generator (likely a gentailer) unreasonably refuses to offer contracts to a rival at the retail level for anti-competitive purposes*".
[21] Frontier Economics, Contract market liquidity in the NEM (May 2018), page 13.

3. Proposed Treasurer-ordered remedies inappropriate and lack procedural fairness

3.1. Proposed enforcement framework for Treasurer-ordered remedies lacks procedural fairness

Enforcement frameworks should be transparent, proportionate and provide protections for procedural fairness. AGL has significant concerns with the proposed enforcement framework for the Treasurer-ordered remedies (see Section 3.2).

The framework allows the ACCC to form a view about whether an electricity company has engaged in prohibited conduct and then engage in "a notice and response process with the corporation" which could result in a range of punitive remedies imposed by the Treasurer. The Treasurer is to make his or her determination based on a recommendation from the ACCC supported by an ACCC report.

AGL has significant concerns about the lack of protections for procedural fairness for the process leading to the ACCC's recommendation and Treasurer's determination, particularly given the serious consequences of the proposed remedies. In particular:

- The ACCC is only required to "identify misconduct". The ACCC is not required to set out the material facts and contentions upon which it relies or to disclose the "evidence" it has had regard to. No evidentiary standard is applied and consequently the ACCC could "identify misconduct" based on speculative, erroneous or misconceived assertion or analysis.
- The respondent company has minimal opportunity to understand the case against it and to respond to the ACCC.
  - The proposed framework does not require the ACCC to provide any document similar to a court pleading when notifying the corporation about the alleged conduct. This deprives the respondent company of the ability to fully understand the case against it and adequately respond to the allegations or rectify the conduct.
  - The proposed timeline of 30 days to respond to an ACCC notice is extremely short and disproportionate to the proposed remedies.
- The respondent company appears to have no opportunity to make submissions to the Treasurer directly or to respond to the report presented to the Treasurer by the ACCC. AGL strongly considers that it is inappropriate for the ACCC, as the investigator, to have the power to make recommendations to the Treasurer which cannot be tested or adequately defended by the respondent company.
- There appears to be a minimal oversight for the Treasurer's determination process. The Consultation Paper notes that merits and judicial review would be available for the Treasurer's determinations. These protections, particularly that of merits review, are essential. However, AGL would be greatly concerned should the review process be limited in scope and application. In order for the process to be in any way tenable, the ACCC report would need to be subject to merits review.

3.2. Treasurer-ordered remedies inappropriate, disproportionate and will deter investment

AGL opposes each of the Treasurer-ordered remedies, which are inappropriate, disproportionate and will deter investment in the electricity sector.

AGL opposes the proposed divestiture remedy in the strongest possible terms. AGL's firm view is that this remedy is neither necessary nor justified. Further, given the lack of procedural fairness protections for

this remedy its existence is likely to be distortionary on the proper function of the market and business decision making.

- **Remedies are highly interventionist and disproportionate.** Each of the three Treasurer-ordered remedies will fundamentally alter the businesses affected. Placing a limit on a business' pricing discretion for its products (retail electricity offers) will limit its ability to recover costs, price discriminate and potentially require it to sell those products at a loss (depending on its costs, hedge position *etc*). Requiring a gentailer to supply a minimum volume of hedge contracts has the potential to materially reduce that business' ability to hedge efficiently and to operate and maintain its generation assets efficiently. This remedy is likely to increase the costs of a vertically integrated retailer in serving its own customer base, as it reduces the business' ability to cost-effectively manage pool price risk associated with its own retail customers. Forced divestitures will break an efficient business apart, which is likely to result in less efficient remaining businesses.

  Accordingly, the use of these remedies is likely to negatively impact electricity prices and harm consumers. The impact on the targeted business is likely to be disproportionate and punitive in nature.

  As the ACCC stated in its Final Report concerning a divestiture remedy (which it did not recommend):

  > "*Requiring the divestiture of privately owned assets* ***is an extreme measure to take in any market****, including the electricity market.*"[22]

  ACCC Chairman Rod Sims has since publicly explained that he does not support a divestiture power:

  > *"I've long thought divestiture is a very big stick, very much last resort, and having that power on a continuing basis I think is tricky."*[23]
  >
  > *"… my personal view is that divestment is probably not the best way to deal with energy prices…"*[24]
  >
  > *"Divestiture is such an extreme step that we felt that judgement would be very hard to reach"*[25]

  Mr Sims gave similar evidence before Senate Estimates:[26]

  > ***Senator KETTER****: … Did you provide a recommendation to the government for divestment powers in the energy sector?*
  >
  > ***Mr Sims****: No, that wasn't one of our recommendations. I guess we took the view that there should be a range of forward-looking measures to promote competition…*

  There is no basis for such interventionist remedies, which are incompatible with the economic and competition principles that underlie Australia's electricity markets and economy more generally. If the new prohibitions were to be introduced, the Consultation Paper offers no justification as to why the existing and established classes of remedies under the CCA (notices and Court-ordered penalties) are insufficient.

- **Remedies will deter investment**. Given the significant uncertainty of these prohibitions, the lack of procedural fairness and the disproportionate and punitive nature of these remedies, their existence will significantly reduce investment incentives in the electricity sector – particularly investment in new large scale generation capacity.

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[22] ACCC, Final Report, page 89.
[23] Sky News, 12 Sept 2018 – Rod Sims interviewed by Trading Day.
[24] Radio National, 31 Oct 2018 – Fran Kelly interviews Rod Sims.
[25] Sydney Morning Herald, 25 Oct 2018 – Competition chief learnt of controversial energy plan when he 'read about it in the newspaper'.
[26] Senate Estimates Hearing, Economics Legislation Committee, 25 Oct 2018, – Rod Sims Evidence.

Divestiture of assets is unlikely to address the underlying causes of higher energy prices (which include policy uncertainty, increasing input costs, and shortage of dispatchable generation capacity). AGL believes that uncertainty in the market, particularly around energy policy and regulation, have been and continue to be a primary disincentive to large scale generation investments. Large scale generation investments require a stable policy environment to provide confidence of a return on investment, not subject to uncertainty and highly interventionist remedies.

Vertically integrated retailers have been the predominant investors in new supply for the last 10 years, 60%. AGL has committed to five major power generation projects over the past year, totalling 1,200MW of new capacity, which will put further downward pressure on prices. These include the:

- 100MW capacity upgrade at the Bayswater Power Station in NSW;
- 252MW Newcastle Gas Power Station at Tomago NSW;
- 200MW Barker Inlet Power Station in SA;
- 464MW Coopers Gap Wind Farm in QLD; and
- 200MW Silverton Wind Farm in NSW.

In total, this is a $2 billion capital investment. AGL is contributing $900 million from its balance sheet and 20% of shared equity as part of the Powering Australian Renewables Fund for the remaining $1.1 billion.

The proposed divestiture remedy and the lack of procedural fairness in the enforcement process would have a chilling effect on necessary investment in large scale, dispatchable generation capacity.

ACCC Chairman Rod Sims has alluded to this potential for the threat of divestiture to create unnecessary uncertainty:

> *"…I think [a divestiture power] is a stick that would be called on to be used many more times than would ever make sense to use it."*[27]

> *"… I think divestiture powers are very tricky things because you can't narrow them to one market. If you have divestiture powers, people are going to ask you to use them left right and centre."*[28]

- **Divestiture remedy will not address market issues.** To the extent that the divestiture remedy is intended to address concerns with vertical integration, there is no economic justification for requiring vertically integrated retailers to divest assets, nor any basis for concluding that such a remedy would address the public concern about high energy prices. As described above, the economic analysis indicates that vertical integration does not reduce contract liquidity, increase the ability or incentive for gentailers to withhold of capacity in the wholesale market or cause increases in spot prices. There is no nexus between divesture of assets and the conduct such a direction purports to address. Divesture in this context is a penalty rather than a remedy.

  In its Final Report, the ACCC itself concluded that a divestiture remedy was not appropriate, and did not recommend its introduction:

  > *"…the ACCC does not believe it would be appropriate to intervene to unwind the way in which the market has evolved across the NEM."*[29]

[27] Radio National, 31 Oct 2018 – Fran Kelly interviews Rod Sims.
[28] Sky News, 12 Sept 2018 – Rod Sims interviewed by Trading Day.
[29] ACCC, Final Report, page 89.

Similarly, the Harper Review widely consulted on the introduction of a divestiture remedy but concluded that the existing range of remedies under the CCA were sufficient to deter a company from misusing its market power.[30]

[30] Competition Policy Review, Final Report, March 2015, page 345.

Annexure A

AGL has been working to improve affordability by:

- Cutting electricity prices in New South Wales, Queensland and South Australia.
- Investing in new generation capacity, as discussed above, AGL and our partners are currently developing 1,200 megawatts of new generation capacity, representing investment of more than $2 billion.
- The Energy Insights[31] service to help customers understand energy usage by appliance category.
- Introducing AGL Essentials,[32] which is a fixed low-rate offer presented as a dollar amount per day that is easy to understand.
- Introducing AGL Prepaid[33] to give customers more control over when and how much they pay.
- The Here to Help service[34] to help customers connect with tailored financial assistance options.
- The Fairer Way program[35] to support low-income and vulnerable households. AGL also has a Staying Connected program to support customers in financial hardship.[36]
- As part of AGL's FY18 Full-Year Results announcement,[37] AGL announced initiatives for vulnerable and standing offer customers including:
  - A new $50 million relief program for Staying Connected customers, including cancelling debts aged more than 12 months and offering dollar matching on other debt repayments.
  - Extending the standing offer loyalty plan to customers in all states (South Australia, Victoria, New South Wales and Queensland) providing automatic loyalty discounts to electricity customers on standing offers who have been with AGL for at least two years.
  - Launching a guaranteed annual plan review for all standing offer customers.
  - Launching a new Small Business Assist energy advice, efficiency and financial counselling program.

[31] https://www.agl.com.au/help/managing-my-account/energy-insights
[32] https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2018/january/agl-simplifies-energy-with-low-and-fixed-rate-digital-only-energy-plan
[33] https://campaign.agl.com.au/landing/residential/prepaid-tl/?webid=PrepaidAQValue1
[34] https://www.agl.com.au/heretohelp
[35] https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2017/march/agl-announces-a-fairer-way-package-for-vulnerable-customers
[36] https://www.agl.com.au/help/payments-billing/staying-connected-hardship-program
[37] https://www.agl.com.au/about-agl/investors/results-centre; https://www.agl.com.au/-/media/aglmedia/documents/about-agl/asx-and-media-releases/2018/180809fy18resultspresentation1829086.pdf