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Director
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Australian Competition and Consumer Commission
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Draft Guidelines on Part XICA - Prohibited conduct in the energy market consultation 2020

Dear Director

The Business Council welcomes the opportunity to make a submission to the Australian Competition and Consumer Commission (the Commission) regarding the Guidelines on the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Act 2019 (the Act).

As stated in previous submissions and inquiries, it is the Business Council's strong contention that the Act is an inappropriate mechanism for addressing energy affordability concerns. We are deeply concerned that its application in the energy market risks exacerbating the underlying source of the problem — namely, investment uncertainty.

Notwithstanding our position on the legislation, the Business Council fully appreciates the critical role the Guidelines will play in clarifying how the Commission will seek to enforce the Act. To avoid (or at least minimise) exacerbating sovereign risk and interference in efficient market outcomes, energy businesses need as much as clarity and certainty as practicable, about what conduct is likely to be prohibited and what conduct is not likely to be prohibited, going forward.

We acknowledge the Commission's efforts thus far in drafting these Guidelines. Our specific comments on the Guidelines have been structured as follows:

- retail pricing provisions;
- electricity financial contract liquidity provisions;
- electricity spot market provisions;
- enforcement and remedies;
- public messaging about the new powers; and
- impact of COVID-19 and implementation of the new powers.

Retail pricing provisions

We note that the fundamental purpose of these new powers is to guard against market conduct that is detrimental to competition and consumer welfare. However, no matter how well intentioned or designed, regulatory interventions run the risk of interfering with the competitive process, stifling market innovation and reducing consumer welfare as a result. This risk is highest in markets characterised by relatively low barriers to entry and strong rivalry among numerous participants, such as the energy market in Australia.

Potential frequency of price adjustments

The complexity and cost associated with adjusting retail prices are substantial. It is not just retailers, but their customers, that are impacted by price adjustments. Retailers incur system and personnel costs some of which are passed through competitively to customers. The customer experience is also made that much more complex because of the communications required to inform customers each time their prices are adjusted.

The retail pricing provisions suggest that the frequency of price adjustments could be greater than retailers' annual price reset cycles. Paragraph 2.25 and Example 8 strongly imply that any required price adjustment that is more than 3 months away from a retailer's scheduled price reset would require an out-of-cycle price adjustment. The prospect of multiple, potentially overlapping price adjustments per year could supress innovation as retailers respond rationally by simplifying and reducing the range of products offered in the market (to minimise the cost and complexity of multiple price resets).

Limiting potential price adjustments under these provisions to be aligned with retailers' annual price reset cycles is preferred and would minimise the additional costs and complexity referred to above.

At the very least, these provisions would be improved if they explicitly stated that out-of-cycle price adjustments would only occur in exceptional circumstances. That is, when the required adjustment was very substantial and/or when its timing was too close a retailer's annual price reset for it to be incorporated by the retailer.

Fixed price contracts

The application of these provisions to fixed price contracts appears to run counter to the nature of such product offerings. Offering fixed price contracts is one of the few ways energy retailers are able to be innovative in the supply what is essentially a utility. Customer segments that purchase fixed price contracts value the certainty they provide, and retailers take this certainty into account when pricing these products.

Example 10 in the Guidelines is welcomed because it makes clear that pre-existing fixed price contracts up to 12 months duration will not be exposed to price adjustments under these provisions. However, fixed price contracts up to 24 months duration are not uncommon in the market. Example 10 also makes it clear that these contracts would almost certainly be subject to price adjustment under the provisions. This introduces additional risk to retailers offering long term fixed contracts and the pricing of these products (if they remain in the market at all) will be less attractive to customers as a result.

We note that the impact of these provisions on long term fixed contracts is exacerbated by the fact that the provisions are obviously not symmetrical to substantial market wide cost increases and subsequent upward price adjustment. Unlike floating or variable priced contracts, the very nature of fixed contracts means that retailers must bear the risk of cost increases.

Retrospective adjustments

Paragraph 2.42 of the Guidelines allows the Commission to consider reductions in the underlying cost of procuring electricity that occur, or partially occur, prior to commencement of the Act from 10 June

2020. This serves to introduce open-ended retrospectivity informally into the Act and therefore an even greater degree of uncertainty overall for energy businesses. It doesn't seem efficient or equitable to potentially impose price adjustments on businesses in retrospect and begs the question of how far into the past the Commission believes is appropriate to review. The Act itself also does not clearly contemplate retrospective operation so it would arguably be contrary to accepted principles of statutory interpretation for the Commission to seek to apply it retrospectively.

Transparency and consistency in price monitoring

Paragraphs 2.36, 2.37 and 2.38 of the Guidelines refer to the Commission's routine monitoring of cost changes in the market (Electricity Monitoring Inquiry) and other cost and price forecasts and relevant analyses by the Australian Energy Regulator and the Australian Energy Market Commission. The market would be served by the maximum degree of consistency in methodology and use of assumptions across these monitoring exercises, particularly with respect to determining market wide cost reductions under these provisions. The market would also be served if the Commission flagged publicly, in advance of any interrogation of individual retailers' prices, the identification of market wide cost reductions for the purposes of these new powers. This would give energy businesses the maximum amount of time to analyse their market offers and potentially prepare for any adjustments required at the next planned price reset opportunity.

Electricity financial contract liquidity provisions

The compliance burden associated with section 153F of the Guidelines is exacerbated by the somewhat open-ended definitions of i) the types of financial contracts; and ii) the counter parties, these provisions are aimed at. As currently drafted, financial contracts are defined as any contract that is not a physical contract settled through the wholesale spot market, and, relevant counter parties are defined to include large commercial and industrial customers and all financial intermediaries.

The revised explanatory memorandum (EM) gives clearer guidance in this regard. Paragraph 2.48 of the EM states that these provisions are "aimed at […] generators, including gentailers", and paragraph 2.62 of the EM refers to traditional "bilateral contracts" and "exchange traded futures and options". Importing these tighter definitions into the relevant sections of section 153F would minimise the compliance burden on energy businesses, without weakening the intended effect of these provisions. That is, it avoids the need for <u>all</u> financial contracts to be reviewed and instead would enable a prudent energy business to focus its efforts and resources on those financial contracts that these provisions were intended to cover.

Electricity spot market provisions

Sections 153G and 153H of the Guidelines create uncertainty in relation to assessing whether a corporation has engaged in conduct with the 'purpose' of distorting or manipulating prices. The wholesale electricity market design shifts the risk of the large, lumpy investments required to fund new generation assets from consumers to industry participants, who are better placed to manage such risk.

Paragraph 4.26 of the Guidelines is welcomed in that it acknowledges the importance of the market design principles and strategies undertaken by energy businesses to optimise their operations as part of managing this risk. However, the Guidelines do not refer to the long timeframes relevant to these investment decisions that underpin long lived generation assets. Such uncertainty has the potential to chill investment. For example, paragraph 4.21 refers to case law relating to the financial market's market manipulation prohibition in the Corporations Act, <u>without</u> discussion of the appropriate time period over which supply and demand ought to be considered. Moreover, there is no discussion or acknowledgement of the risks faced by energy businesses that own and operate long lived assets in what has typically been a very uncertain commercial and policy environment in recent decades.

If the Commission is to draw on case law arising from market manipulation in other financial markets to assess whether or not there is a contravention of sections 153G or 153H, there should be greater clarity on how the Commission intends to interpret the concepts from those cases in the context of the electricity sector's wholesale market design. This is because there are important physical differences in the way the wholesale electricity market operates, compared to the financial market(s).

Enforcement and remedies

Chapter 6 of the Guidelines could provide greater clarity and certainty to energy businesses if it included a fuller description of the Commission's intended approach to enforcement. Guidance offered in paragraph 6.27 — that contracting orders and divestiture orders would only be deployed for "the most serious" conduct — is welcomed guidance in this regard. However, it would also be helpful if the following could be elaborated upon in the Guidelines:

- references to a "graduated range of remedies" contained in the EM;
- circumstances surrounding when a corporation's 'purpose' may be inferred from its 'conduct', as per section 153J of the Act; and
- the circumstances when these new powers would be used versus when section 46 of the existing powers would be used where there was potential for overlap.

Public messaging about the new powers

There is a danger that the introduction of these new powers creates the inappropriate expectation that energy prices will necessarily fall as a result. In our view, these new powers are a policy 'back stop' in a market that already has all the preconditions necessary for effective competition, such as low barriers to entry, numerous participants and strong rivalry among participants.

However, if these new powers are publicly promoted as a 'big stick' with which to bring down energy prices, then customers would understandably expect energy prices reductions as a matter of course following their introduction. The front-line staff at energy businesses would bear the brunt of this confusion and mismanagement of expectations, and customers' overall experience with their energy provider would suffer.

We strongly urge the Commission to coordinate any messaging about the introduction of the new powers with both Government and industry.

Impact of COVID-19 and implementation of the new powers

The uncertainty created by COVID-19 is impacting the operational and human resource functions of businesses across the economy to varying degrees. While energy businesses have been (and will continue) preparing for commencement of the Act from 10 June, their resources and attention have necessarily been focused on ensuring that their businesses can continue to operate through the significant challenges affecting their employees, customers and suppliers, caused by COVID-19.

On behalf of its members, given the current circumstances the Business Council asks that the Commission formally adopt a 'training wheels' approach to compliance and enforcement for at least six months from 10 June, to allow energy businesses to familiarise themselves with the new powers with the benefit of the Commission's final guidelines. During this six month period the Commission would play an educative role with respect to the new powers by, for example:

- monitoring and calling out substantial market wide reductions (should they occur) without graduating to the next step of monitoring individual businesses' pricing responses.
- monitoring and calling out examples of bidding behaviour with the potential to contravene the new powers and engaging in a dialogue with market participants about the Commission's reasoning, without graduating to the next step of taking enforcement action.

Please contact us on 03 8664 2664 if you have any questions. Thank you again for the opportunity to provide feedback.

Yours sincerely

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Chief Executive