AGL Energy Limited
T 02 9921 2999
F 02 9921 2552
agl.com.au
ABN: 74 115 061 375

Level 24, 200 George St
Sydney NSW 2000
Locked Bag 3013
Australia Square NSW 1215

Lyn Camilleri

General Manager, Electricity Markets Branch

Australian Competition and Consumer Commission

Level 17, Casselden

2 Lonsdale Street

Melbourne VIC 3000

electricitymonitoring@accc.gov.au

6 January 2020

Dear Ms Camilleri,

AGL welcomes the opportunity to provide input on the issues to be addressed in the ACCC enforcement guidelines (**ACCC Guidelines**) on the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Act 2019* (**the Act**), which will introduce a new Part XICA into the *Competition and Consumer Act* 2010 (Cth) (**CCA**) and come into effect six months following Royal Assent (given on 10 December 2019).

The ACCC Guidelines will play an important role in providing AGL and other market participants with greater certainty and clarity as to how the new prohibitions in Part XICA are intended to operate and resolve some of the complex issues of application that arise from the drafting of those prohibitions in the Act. This is vital given that the nature and scope of the remedies available to the ACCC are also uncertain and have the potential to the exercise of broad discretionary powers that directly interfere with contractual matters between private businesses and seeking divestment orders from a Court.

Given the potential consequences for breaching Part XICA, AGL considers that the ACCC Guidelines should, at a minimum, address the following:

- ***Interpretation*** – the ACCC's view on interpreting each of the new prohibitions, including the key concepts in each prohibition. In setting out its views on interpretation, AGL considers that the ACCC should have regard to well-known concepts in the electricity industry as well as the specific design of the National Electricity Market (**NEM**). The ACCC should also have regard to the Explanatory Memorandum (the **EM**) accompanying the Act;
- ***Examples*** – specific examples of conduct that the ACCC considers are likely or unlikely to be in breach of the new prohibitions, with examples that are relevant for a range of market participants – noting that some may have more complex corporate structures than others;
- ***When enforcement action is more likely than not*** – the types of conduct the ACCC would consider to be the most egregious breaches of Part XICA, and factors that it would consider when deciding to take enforcement action. In particular, it would assist to understand the ACCC's views regarding the types of conduct where it is more likely to recommend divestment or a contracting order as a remedy, or when it is likely to seek civil penalties against a corporation and/or its directors, secretaries and/or senior managers;

- ***Process and procedure*** – procedural fairness and other due process considerations that the ACCC will adopt when investigating potential breaches of Part XICA, issuing public warning notices and making prohibited conduct recommendations to the Treasurer; and
- ***Interactions with other ACCC roles in monitoring the electricity industry*** – in terms of further guidance, it would assist if the ACCC could explain how they see enforcement of Part XICA interacting with its other electricity industry monitoring activities, including enforcement of the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019* and the Electricity Monitoring Inquiry.

The above matters are set out in more detail in the attached submission to this letter. AGL has included suggested examples in a confidential annexure, with the purpose of ensuring AGL is not inadvertently suggesting to its competitors how it might respond in a particular scenario.

AGL recognises the challenge the ACCC faces in developing the ACCC Guidelines given the prohibitions and remedies in the Act are without precedent and unclear. AGL appreciates the ACCC's approach to engagement with market participants regarding its Guidelines and looks forward to participating in the ACCC's consultation process once it has issued draft guidelines.

Please do not hesitate to contact me on (03) 8633 6077 or Adelina Widjaja on (02) 9921 2239 if you have any questions in relation to this submission.

Yours sincerely,

Beth Griggs
General Manager Competition Regulation & Strategy

Initial consultation on ACCC guidelines on the Prohibiting Energy Market Misconduct Act – Submission to the ACCC

1. Executive summary

AGL thanks the ACCC for its invitation to make submissions on the approach to the guidelines it plans to issue (**ACCC Guidelines**) setting out its enforcement role in relation to the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Act 2019* (**the Act**). Under the Act, which inserts a new Part XICA into the *Competition and Consumer Act* 2010 (**CCA**), the ACCC will have additional enforcement powers and remedies to take action against firms who may be engaging in market misconduct in the electricity sector. These powers and remedies are significant and the breadth of the new prohibitions is unclear, with the potential to increase the compliance burden on market participants and cast doubts over what has been legitimate business-as-usual conduct in the industry for some time. The ACCC's enforcement approach should take this into account and ACCC enforcement action should be measured and accompanied with substantive procedural fairness.

AGL appreciates the ACCC has reviewed the public submissions made to previous consultation processes on the substance of the Act. This submission does not seek to repeat statements of concern regarding the prohibitions and remedies in the Act that AGL has made in those processes and is instead focused on providing detailed input to inform the ACCC's enforcement approach in accordance with the ACCC's list of issues for consultation.

In summary, AGL's views on the issues for consultation are as follows:

Key concepts

AGL considers that the ACCC's interpretation of the key concepts in the new prohibitions should be informed by the following principles:

- as a general matter, in terms of overall approach:
    - the ACCC's objective in developing the ACCC Guidelines should be to provide information that will assist and allow responsible market participants to achieve compliant outcomes and to understand clearly what is likely to fall foul of the prohibitions in the Act. If that objective is achieved, then enforcement action should only be taken against parties that have engaged in conduct with reckless indifference to their compliance obligations, rather than parties that were acting in good faith but with a different view as to what constitutes compliant conduct;
    - the Explanatory Memorandum (the **EM**) accompanying the Act sets out some useful principles of interpretation that the ACCC should take into account. The EM, as extrinsic material that the Courts may have regard to in interpreting a statute that is ambiguous, provides useful guidance on concepts embedded in the retail pricing prohibition (section 153E) and also factors to be considered in relation to whether a corporation has breached the contracting (section 153F) or bidding prohibitions (sections 153G and 153H);
- specifically, in relation to each prohibition:
    - **retail pricing prohibition** – this provision requires that a retailer make reasonable adjustments in response to a "*sustained and substantial reduction in the underlying cost of procuring electricity*". In determining whether there has been such a reduction, the EM suggests the ACCC should adopt a two-step process:
        - The first step should be to consider whether there has been a sustained and substantial reduction in the costs incurred by a benchmark prudent and efficient new entrant retailer.

The wholesale energy cost (**WEC**) component should be assessed with reference to observable forward market prices with appropriate allowances for risk.

- The second step is to consider whether there are any circumstances particular to the retailer in question that mean that retailer has not experienced a sustained and substantial reduction in costs.

The ACCC then needs to consider whether, in light of that sustained and substantial reduction, "*reasonable adjustments*" to retail pricing have been made. These "*reasonable adjustments*" should not require retailers to continually adjust prices or lower all prices equally in correlation with the substantial and sustained reduction – the notion of "*reasonable*" should take into account how retailers typically set and adjust prices within business-as-usual processes, and what adjustments they have made in previous years;

- **contracting prohibition** – the concept of an offer that has the effect or likely effect of "*preventing, limiting, or restricting acceptance of those offers*" should not require a corporation to enter into contracts on terms or conditions that are not commercially acceptable to the corporation; and
- **bidding prohibition** – the concepts in this prohibition should be interpreted having regard to the design of the National Electricity Market (**NEM**). In addition:
  - "*fraudulently, dishonestly, or in bad faith*" – the ACCC should have regard to the bidding and rebidding rules in the National Electricity Law (**NEL**). While those rules prohibit bids or rebids that are false, misleading or likely to mislead, those concepts are similar in that they involve some element of deception and/or a generator not having an intention to honour a bid. In addition, consistent with other legal definitions, these concepts require some element of dishonesty or deception; and
  - "*distorting or manipulating prices*" – this concept has to mean something more than a generator seeking to bid in a way that optimises its portfolio of assets or in a profit-maximising way. The ACCC should keep foremost in mind that the NEM was designed to permit bidding that would deliver prices significantly higher (and lower) than costs at different points in time, with higher prices being essential to incentivising investment. The NEM was also designed on the premise that generators would contract (both with wholesale and retail customers), and their conduct in the spot market would be reflective of their contract position.

Examples of conduct likely to, or unlikely to, breach the new prohibitions

- The ACCC Guidelines should include a range of examples (not just extreme examples) of conduct that the ACCC views as being likely or unlikely to be in breach of the new prohibitions.
- There should be examples for different types of market participants – from small electricity retailers to generators with multiple plants and units that may also have a downstream retail business to government-owned operators, retailers or generators. It is important that the examples address the complexity and range of generation assets and the issues they face, contracting positions, corporate structures and ownership models in the electricity industry.
- AGL understands that the examples in the ACCC Guidelines will not be able to capture the full scope or complexity of day-to-day decision making that could potentially come under scrutiny under the Act, or act as a substitute for market participants seeking their own legal advice.
- AGL has included a number of examples of conduct that it considers is unlikely to breach the new prohibitions in Confidential Annexure A and considers that the suggested examples align with the fundamental principles in the EM.

Processes and remedies

AGL considers that the following information regarding the ACCC's approach to the new remedies in Part XICA should be included in the ACCC Guidelines:

- ***When enforcement action is more likely than not*** – the types of conduct the ACCC would consider to be the most egregious breaches of Part XICA, and factors that it would consider when deciding to take enforcement action. In particular, it would assist to understand the ACCC's views regarding the types of conduct where it is more likely to recommend divestment or a contracting order as a remedy, or when it is likely to seek civil penalties against a corporation and/or its directors, secretaries and/or senior managers. AGL notes its comments below to the effect that it believes there should be careful consideration given to the appropriateness of enforcement action in circumstances where a corporation has sought to be compliant, but due to the uncertainty attached to the new provisions, has engaged in conduct that the ACCC believes to be non-compliant. Further, in respect of individuals, AGL suggests there should be a policy of not pursuing any individual liability where the individual was making decisions which he or she believed to be consistent with compliant outcomes; and
- ***Procedural fairness and other due process considerations*** – given market participants expressed concerns about the lack of procedural fairness in the Act prior to enactment, the ACCC Guidelines should set out clearly the steps it will take when investigating potential breaches of Part XICA, issuing public warning notices and making prohibited conduct recommendations to the Treasurer. The ACCC may also wish to consider whether there needs to be additional notice and consultation – beyond what is stipulated in the Act – in order to afford corporations greater procedural fairness, such as providing corporations with copies of the prohibited conduct recommendation that has been provided to the Treasurer that recommends a contracting or divestiture order.

Further guidance

Lastly, it would assist if the ACCC could explain how they see enforcement of Part XICA interacting with its other electricity industry monitoring activities, including enforcement of the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019* (**DMO Code**) and the Electricity Monitoring Inquiry.

2. Key concepts

The ACCC is seeking stakeholder input on the key concepts in the Act that the ACCC Guidelines could meaningfully clarify and any views on appropriate interpretation in the context of the electricity industry. AGL sets out its views on the principles of interpreting the key concepts below. Most of these principles are outlined in the EM and AGL has included the references where relevant.

2.1. Retail pricing prohibition

Section 153E provides that a corporation engages in prohibited conduct if it:

- offers to supply, or actually supplies, electricity to small customers (residential or small business consumers); and
- fails to make reasonable adjustments to the price of those offers or supplies to reflect reductions in its underlying cost of procuring that electricity (the **retail pricing prohibition**).

In enforcing this retail pricing prohibition, the starting proposition for the ACCC should be that contestable retail electricity markets are competitive and operating efficiently. According to the AEMC's 2019 Retail Energy Competition Review Final Report (28 June 2019):

> "*Outcomes for consumers in contestable retail electricity markets improved this year. Increased competition led to decreases in prices and reductions in market concentration in all markets except Tasmania. New and emerging retailers are driving lower prices and the market is starting to shift towards simpler and more comparable pricing structures, and greater product innovation.*"[1]

In these circumstances, the retail pricing prohibition is largely redundant as retailers will reduce prices where possible in order to remain competitive. This is the case even with the re-introduction of retail pricing regulation, with retailers continuing to compete by offering market offers below the Default Market Offer (**DMO**) and Victorian Default Offer (**VDO**). In this context, AGL notes that in the Retail Electricity Pricing Inquiry (**REPI**) the ACCC identified issues associated with high standing offer prices and lack of transparency and comparability associated with discounting off varying market prices. Both of these issues have been addressed through other regulation. The ACCC did not identify issues with the pricing of competitive market offers made to customers who engage with the competitive market.

To determine whether a retailer has breached the retail pricing prohibition, the ACCC should adopt the following process as outlined in the EM:[2]

> *"whether any reductions in supply chain costs are sustained and substantial, with reference to broad, market-wide price trends;*
>
> *whether, when and how adjusting prices in response to a relevant reduction would be 'reasonable', taking into account the particular circumstances of the retailer in question (including that retailer's overall operating costs)."*

In terms of the key concepts, this can be interpreted and applied in the following manner:

- "*sustained and substantial reduction*" – as per the EM:
  - The first step should be to consider whether there has been a sustained and substantial reduction in the costs incurred by a benchmark prudent and efficient new entrant retailer. The WEC component should be assessed with reference to observable forward market prices with

[1] AEMC, *Final Report: 2019 Retail Energy Competition* Review, 28 June 2019, paragraph 8.
[2] Revised Explanatory Memorandum, *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019*, paragraph 2.35 (**Revised Explanatory Memorandum**).

appropriate allowances for risk. These are concepts that are well understood via past regulated pricing processes.

- The second step is then to consider whether there are any circumstances particular to the retailer in question that mean that retailer has not experienced a sustained and substantial reduction in costs.

  The DMO and VDO are not determinative of whether there has been a sustained and substantial reduction. A decrease to the DMO or VDO should be considered as indicative only;

- "*underlying cost of procuring electricity"* – the EM states that the costs relevant to determining the "*underlying cost of procuring electricity*" are the WEC, network costs and environmental costs;
- "*reasonable adjustment*" – to interpret this concept within the context of the electricity industry, there should be no requirement for retailers to continually adjust prices or lower them in uniformity with the substantial and sustained reduction – the notion of "*reasonable*" should take into account how retailers typically set and adjust prices within their business-as-usual processes. In particular:
  - "*reasonable adjustments*" should not be interpreted to require more than one price adjustment per year, noting the current activity that occurs in response to market conditions such as adjusting market offers;
  - retailers should not be prohibited from 'smoothing' price changes across periods. For example, a retailer may choose not to pass through a full increase in costs to its customer base in one year, as it anticipates a decrease in the following year. The retail pricing prohibition should not be interpreted or enforced such that the retailer is concerned it would be forced to pass through the full cost reduction in the following year, even though it had not passed through the full cost increase in the previous year;[3]
  - retailers should not be required to reduce each customer's rate/tariff by the same amount;[4]
  - the ACCC should recognise that retailers offering new products at lower prices (often expressed as an increased discount) throughout the year are in fact offering a price reduction to customers. As retailers observe (or anticipate) their costs decreasing, they pass through those savings to customers by offering lower prices. It is relevant to note that AGL does not charge any contract termination fee, so there is no bar to a customer switching to a lower cost retail product; and
  - "*reasonable adjustments*" would suggest that a retailer would still be able to make adjustments to pricing while earning margins commensurate with its risk profile.

AGL has set out at Confidential Annexure A examples which apply the above principles and interpretation and which it considers should not be in contravention of the retail pricing prohibition.

2.2. Prohibition on failure to offer electricity financial contracts

Section 153F provides that a corporation engages in prohibited conduct if it:

- fails to offer electricity financial contracts;
- limits or restricts its offers to enter into electricity financial contracts; or
- 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; and

[3] Revised Explanatory Memorandum, paragraphs 8.81 to 8.82.
[4] Revised Explanatory Memorandum, paragraphs 2.42 to 2.43 and example 2.4.

the corporation does so for the purpose of substantially lessening competition in any electricity market (the **contracting prohibition**).

The contracting prohibition introduces this concept of a corporation offering to enter into an electricity financial contract that has, or offering terms that have, the effect or likely effect of "*preventing, limiting, or restricting acceptance of those offers*". By way of example, the EM states that a corporation may be in breach of the prohibition if it offers electricity financial contracts on such commercially unattractive terms that no reasonable counterparty would be likely to accept.[5]

AGL understands that what the concept may be targeting here is constructive refusal – where a generator offers contracts on such unrealistic terms that it amounts to a failure or refusal to offer a contract. The ACCC should consider whether this is its interpretation of the concept and further clarify in its ACCC Guidelines that:

- this concept of constructive refusal does not require a generator to offer contracts on terms or conditions that are not commercially acceptable to the generator. AGL notes in this context the EM indicates that a corporation will only be found to have failed to offer an electricity contract if it did not have a good reason for failing to make such an offer.[6] Specifically, no anti-competitive purpose can be inferred solely on the basis that the generator is seeking to legitimately optimise its earnings from generation assets, including earning margins commensurate with the risk it is taking;
- this provision will only apply to a refusal or constructive refusal between a generator and an electricity retailer – i.e. does not apply to negotiations between a generator and end-user customers; and
- to determine whether there has been a constructive refusal (as well as more generally a failure to offer under subsection 153F(b)(i)), the ACCC should take into account the considerations that a prudent generator would consider when assessing the contracts they would offer to the market, including:
    - unit reliability and whether generation capacity is sufficiently firm;[7]
    - planned outages;
    - forecast demand and supply;[8]
    - fuel supply constraints;[9]
    - opportunity costs of fuel;
    - the nature of the product, specifically the shape and volume of the product;
    - the tenure of contracts;
    - credit risk of counterparties;
    - operational and safety considerations; and
    - operational and capital costs.

AGL has set out at Confidential Annexure A examples which apply the above principles and interpretation and which it considers should not be in contravention of the contracting prohibition.

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[5] Revised Explanatory Memorandum, paragraph 2.56.
[6] Revised Explanatory Memorandum, paragraph 2.56
[7] Revised Explanatory Memorandum, paragraph 2.56 and example 2.12.
[8] Revised Explanatory Memorandum, paragraph 2.103.
[9] Revised Explanatory Memorandum, paragraph 2.102.

2.3. Spot market bidding prohibition

Sections 153G and 153H provide that a corporation engages in prohibited conduct if:

- the corporation:
    - bids or offers to supply electricity in relation to an electricity spot market; or
    - fails to bid or offer to supply electricity in relation to such a market; and
- with respect to:
    - the basic case, the corporation does so:
        - fraudulently, dishonestly or in bad faith; or
        - for the purpose of distorting or manipulating prices in that market; or
    - the aggravated case, the corporation does so:
        - fraudulently, dishonestly or in bad faith; ***and***
        - for the purpose of distorting or manipulating prices in that market (emphasis added) (together, the **bidding prohibition**).

As noted above, the concepts of bidding (or not) *"fraudulently, dishonestly, or in bad faith"* and for the purpose of *"distorting or manipulating prices"* are not terms which are used in other electricity industry specific legislation or regulation. No stakeholders have, to date, been able to articulate with any clarity what bidding (or failure to bid) conduct the prohibition is intended to capture. There is, however, acceptance, including in the EM and by the ACCC[10] that the NEM is designed on the premise that generators will bid to maximise economic returns, and that at times of tight supply and demand, the price will rise. Inherent in this premise is an acceptance that generators will not bid with reference to their cost base but will bid with reference to their opportunities to maximise profits. It is therefore very unclear to market participants how the ACCC will draw a distinction between legitimate profit-maximising bidding, and bidding that contravenes the new bidding prohibition, with no legal or market precedents to assist participants in making that distinction.

It would be helpful to all market participants for the ACCC to provide its views in some detail – beyond what is in the language of the bidding prohibition and the EM – on what it considers to be, and not to be, legitimate profit-maximising conduct. In particular, the ACCC should seek to distinguish between such conduct and define what these concepts mean in the context of the NEM by:

- providing guidelines that will provide an ex-ante delineation between legitimate and illegitimate conduct. The ACCC Guidelines should not adopt an approach where it seeks to undertake an ex-post analysis of circumstances and market outcomes to infer a purpose of distorting or manipulating prices – this is because market participants are bidding (or not bidding) with the facts and market circumstances available to them at the time. It would not be appropriate to analyse whether or not that bidding conduct

[10] ACCC, *Restoring electricity affordability and Australia's competitive Advantage – Retail Electricity Pricing Inquiry – Final Report*, June 2018. See, eg, pages vii ("*The NEM was designed such that higher prices would ordinarily be a signal for new investment.*"), 41 ("*The NEM is designed to incentivise new entry or expansion through price signals in the spot market. Frequent or persistent high prices indicate a scarcity of generation capacity and provide a market signal and incentives for new investment.*") and 98 ("*As the NEM is an energy-only market, limited periods of high prices are not unusual and are essential to encourage investment in new generation. What can be difficult is distinguishing high prices which are simply an efficient signal for new investment, and high prices which persist because the market is not working effectively due to a lack of efficient entry taking place. The NEM has, until recently, appeared to have operated well in respect of eliciting a market response to signals of an over- or under-supply of generation capacity.*").

was in breach of sections 153G or 153H with the benefit of hindsight, having regard to the outcomes of that bidding. The ACCC Guidelines should provide market participants a very practical and granular set of principles that enables them to have confidence that the ACCC will regard their conduct as compliant; and

- the ACCC should consider the bidding and rebidding rules in the National Electricity Law (**NEL**), Australian statutes of general applicability and case law in reaching its views on an appropriate interpretation in the context of the electricity industry. These precedents suggest that these concepts involve acts of intentional deception and/or seeking to bid in a non-genuine way to achieve perverse outcomes, with the concept of 'perverse' clearly excluding those outcomes and bidding practices that align with the design of the NEM.

"Fraudulently, dishonestly, or in bad faith"

The EM explains that a corporation "*would act fraudulently, dishonestly or in bad faith where its conduct was aimed at obtaining a financial or competitive advantage by unlawful or unfair means, involved wrongdoing or was not otherwise of a kind that would be expected of a person acting according to the standards of a reasonable and honest person*".[11] AGL considers that the ACCC should provide greater clarity as to what would be considered "*unfair means*" or not in accordance with the standards of a reasonable and honest person, given these can be interpreted quite subjectively.

In providing this clarity, the ACCC may want to have regard to:

- the bidding and rebidding rules in the NEL. While those rules prohibit bids or rebids that are false, misleading or likely to mislead, those concepts are similar in that they involve some element of deception and/or a generator not having an intention to honour a bid; and
- how those terms have been defined in other legal contexts as requiring some element of dishonesty or deception. For example, the *Encyclopaedic Australian Legal Dictionary* offers the following definitions:[12]
    - "Fraud" – "*An intentional dishonest act or an omission done with the purpose of deceiving*";
    - "Dishonest" – this term has been interpreted in a criminal law context to mean "*Discreditable; at variance with straightforward or honest dealing: R v Salvo [1980] VR 401; (1979) 5 A Crim R 1. An act is dishonest if it is done in the knowledge that it will produce adverse consequences for others: R v Bonollo [1981] VR 633; (1980) 2 A Crim R 431*". In NSW, the term is defined in the *Crimes Act 1900* (section 4B) as "*dishonest according to the standards of ordinary people and known by the defendant to be dishonest according to the standards of ordinary people*"; and
    - "Bad faith" – this term has been defined in the content of contract law as "*Deceptive, dishonest or fraudulent; for example, where a power is exercised for corrupt or dishonest motives. Where a promisor is subject to an express or implied obligation of good faith, performance in bad faith constitutes a breach of contract: for example, Shepherd v Felt and Textiles of Australia (1931) 45 CLR 359; Roncarelli v Duplessis (1959) 16 DLR (2d) 689.*"

The above definitions would suggest that fraudulent, dishonest or bad faith bidding (or failure to bid) has to involve an element of intentional dishonesty or deception. In other words, that the purpose or motive driving the bidding behaviour was not a genuine commercial strategy, consistent with the design of the NEM, but one intended to produce outcomes through deception or corrupt motives.

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[11] Revised Explanatory Memorandum, paragraph 2.89.
[12] *Encyclopaedic Australian Legal Dictionary* (online at 23 December 2019) 'fraud', 'dishonest' and 'bad faith'.

"Distorting or manipulating prices"

In terms of general principles, the ACCC should have regard to the design of the NEM when enforcing the bidding prohibition. AGL notes the comments of Mr Michael Cosgrave of the ACCC at the Senate Economics Legislation Committee hearing in October 2019 in which he commented that the ACCC:[13]

> "*are absolutely taking as a given the volatility of the market, and, in enforcing that provision, we will take into account the design of the energy-only spot market, which allows for price volatility, and where high prices are generally a necessary signal for investment. The design of the market is absolutely something that we will take into account if this bill is enacted, in seeking to enforce it.*"

Consistent with this view, a corporation should not be considered to have contravened sections 153G or 153H by bidding in a way that is consistent with, or results in price outcomes or benefits obtained through electricity financial contracts that would be expected having regard to, the design of the NEM. This would also be consistent with the EM, which accepted that reference must be had to the design of the spot market:[14]

> *"It is important that the analysis of whether a corporation acted with the purpose of distorting or manipulating prices be made with reference to the particular design of electricity spot markets.*
>
> *Transitory market power can be an acceptable feature of an electricity spot market because it can create a signal for investors to invest in new generation when and where it is needed by the system. When investors observe transitory market power in action, they are more likely to invest to bring new generation into the market to take advantage of the opportunity, which then helps to drive prices back to reflect underlying costs.*
>
> *Similarly, the design of the spot market allows for price spikes. Short-term price spikes, generally in response to rare peak events, allow for peaking capacity (with higher start-up and operating costs) to remain viable, without requiring new generation to be brought into the system unnecessarily at a cost to consumers."*

In essence, in the context of the NEM, the concept of "*distorting or manipulating prices*" has to mean something more than a generator seeking to bid in a way that optimises its portfolio of assets or in a profit-maximising way.

In interpreting this concept, the ACCC should also:

- avoid an approach that would require a generator to do anything that raises legitimate operational or safety concerns;
- take into account the considerations that a prudent generator would consider when assessing what bidding approach to adopt on a spot market, including:
    - fuel supply constraints;[15]
    - opportunity costs of fuel;
    - operational and capital costs;
    - forecast demand and supply;[16] and

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[13] Commonwealth, *Parliamentary Debates*, Senate, 30 October 2019, page 30 (Mr Michael Cosgrave).
[14] Revised Explanatory Memorandum, paragraphs 2.98 to 2.100.
[15] Revised Explanatory Memorandum, paragraph 2.102.
[16] Revised Explanatory Memorandum, paragraph 2.103.

- the design of the energy-only market, specifically the purpose of price volatility and the price at which the Value of Loss Load (**VoLL**) is set;

- take into account that some generators have a portfolio approach to bidding and, in determining a legitimate risk management strategy, will bid in a way that seeks to optimise its position across its assets and its contract position; and
- continue to acknowledge that generators seek to make an economic return on investment over the long term, and acknowledge the inability of a generator to predict whether or when it will have an opportunity to bid in a profit-maximising manner in the future.

The ACCC Guidelines should clarify that this concept requires an element of intent – that is, the conduct is intended to control or manage an outcome. Effect alone does not necessarily mean that the conduct was a distortion or manipulation of prices. However, there is also a requirement for an effect – that is, an attempted manipulation without effect would not be a contravention.

AGL has set out at Confidential Annexure A examples which apply the above principles and interpretation and which it considers should not be in contravention of the bidding prohibition.

3. Processes and remedies

The ACCC seeks stakeholder input on:

- What information regarding the ACCC's approach to these new remedies should be included in the guidelines?
- What, if any, elements of the relevant processes should the ACCC seek to clarify in the guidelines, and why clarity is required?

AGL's views on these matters is set out below.

3.1. Remedies

As noted above, AGL is of the view that the ACCC Guidelines should provide information on:

- *when enforcement action is more likely than not* – market participants would be assisted by information regarding the types of conduct the ACCC would consider to be the most egregious breaches of Part XICA, and factors that it would consider when deciding to take enforcement action against a corporation and/or individuals; and
- *the criteria the ACCC will apply and circumstances that could lead the ACCC to seek particular remedies* – in particular, it would assist to have the ACCC's views on:
    - when it considers it appropriate to provide a draft warning notice and issue a final warning notice, in particular the factors it will consider to determine if a person has suffered detriment as a result of a corporation engaging in prohibited conduct, and whether it is in the public interest to issue a public warning notice;
    - when the ACCC will issue an infringement notice rather than seek civil penalties or a contracting or divestiture order;
    - circumstances when it is likely to seek Court-ordered civil penalties for a breach of Part XICA against a corporation;
    - circumstances when it will pursue individuals such as directors, secretaries and/or senior managers who may be personally liable for a breach by virtue of subsection 76(1) of the CCA (noting that section 153ZD of Part XICA limits individual liability to senior employees and directors of a corporation);

- when a contracting or divestiture order is a proportionate means of preventing the corporation from engaging in that kind of prohibited conduct in the future. AGL notes that paragraph 4.13 of the EM suggests that in this context "*proportionate*" means "*necessary*" – clearly implying that in order for it to be appropriate to make a contracting order, a lesser remedy than a contracting order would not achieve the relevant object; and
- if the ACCC is recommending a divestiture order, the circumstances in which it will consider that such an order will result, or likely result, in a net public benefit.

It is important that the ACCC clearly articulate what criteria determines whether the ACCC will pursue civil penalties generally available for breaches of Part IV of the CCA instead of a contracting or divestiture order given they are extreme and unusual remedies. AGL's understanding is that such remedies will only be pursued in respect of the most serious contraventions and a divestiture recommended as a last resort. This would be consistent with the EM.[17] AGL notes in this context several statements made in the EM as to the role some of the more extreme remedies in Part XICA are intended to have, including (emphasis added):

> "*It is intended that the making of a contracting order by the Treasurer, or an application to the Federal Court by the Treasurer, would* ***only occur in respect of more serious contraventions****, where such an action is proportional and targeted to the conduct*."[18]; and
>
> "*A court ordered divestiture is intended to be* ***used as a last resort in the most exceptional circumstances*** *where other responses available to the ACCC and the Treasurer would not sufficiently address the alleged prohibited conduct. A divestiture order would only be an appropriate response where the Federal Court has found that the relevant corporation has engaged in prohibited conduct under section 153H (electricity spot market (aggravated case)).*"[19]

AGL suggests the ACCC will need to consider the appropriateness of enforcement action in circumstances where a corporation has clearly demonstrated a commitment to compliance, but has applied a different and genuine view of compliance not consistent with the ACCC's subsequent assessment of liability. The inherent uncertainty that attaches to the completely new legal concepts in Part XICA requires this consideration, particularly in the period following implementation of the new provisions.

In relation to personal liability, given the complexity of the new prohibitions, the ACCC should, accordingly, set a high threshold for when to take action against individuals. Until such time as there is settled law, individuals should not be individually prosecuted unless the ACCC is satisfied that there is evidence of a flagrant and deliberate disregard of the law. In respect of more technical contraventions of the prohibitions, the ACCC should take into account whether an individual's actions are, again, predicated on a different and genuine view of compliance with the law and in accordance with legitimate, business-as-usual conduct that has existed in the sector prior to the Act coming into force before prosecuting that individual.

3.2. Enforcement processes

As an overarching comment, the ACCC's enforcement processes should take into account the following:

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[17] Revised Explanatory Memorandum, paragraphs 1.12, 5.7, 8.53 and 8.91. Specifically, for example, paragraph 8.53 states: "*… The divestiture order power is a significant deterrent, and it may never become necessary to seek such an order*"; and paragraph 8.91 states: "*… The legislative criteria ensure that the appropriate remedy is selected, through a series of tests, including that the chosen remedy must be proportionate (i.e. no more severe than is necessary to address the prohibited conduct in question). In particular, it is intended that the Treasurer would apply to the Court for a divestiture order only as a last resort, and where the public benefit of such action would outweigh any detriment.*"

[18] Revised Explanatory Memorandum, paragraph 1.12.

[19] Revised Explanatory Memorandum, paragraph 5.7.

- market participants expressed concerns about the lack of procedural fairness in the Act prior to its enactment and no amendments were made to the Act to address those concerns; and
- the Act introduces new concepts and prohibitions which are, in the ACCC's own words, of complex application.[20] Without diminishing the need for the ACCC to pursue the most serious misconduct, the ACCC's enforcement processes should therefore be appropriately measured in the initial period after the Act comes into effect. This is particularly important as these new prohibitions will apply in an already complicated and highly regulated sector, with significant changes to market design and regulation anticipated (e.g., the introduction of 5-minute settlement) in the short to medium term.

Given these concerns, the ACCC Guidelines should:

- set out the steps (e.g., in a process flowchart) the ACCC will take to investigate and enforce the new prohibitions, so there is clarity and transparency in relation to how the ACCC interprets the procedural requirements of the Act;
- consider processes that it may wish to adopt to provide sufficient certainty and clarity for market participants, which may go beyond what is expressly provided for in the words of the statute. In particular, additional notice and consultation may be necessary in order to afford corporations greater procedural fairness, especially where there is the potential for contracting or divestiture orders as remedies; and
- contain processes that are consistent with the ACCC's own Compliance and Enforcement Policy in relation to the CCA. As this policy states, two of the principles which govern the ACCC's compliance and enforcement work are 'transparency' and 'fairness', which have a number of aspects, including to be "*transparent about what action the ACCC is taking and why.*"[21] Principles in relation to confidentiality, timeliness and proportionality are also relevant to enforcement processes under the CCA.

AGL expects it will have more specific inputs once the ACCC issues draft guidelines but two areas which the ACCC should seek to provide more clarity on in accordance with the above principles are in relation to public warning notices and prohibited conduct recommendations.

Public warning notice

Pursuant to section 153L, the ACCC may give a corporation a draft warning notice if it reasonably believes that:

- a corporation is engaging, or has engaged, in prohibited conduct;
- one or more persons has, or is likely, to suffer detriment as a result of the prohibited conduct; and
- it is in the public interest to do so.

The draft warning notice must explain the reasons why the ACCC reasonably believes the above requirements are met. The ACCC must also consider the above criteria when deciding whether to issue a public warning notice under section 153M.

AGL considers that the ACCC Guidelines should clarify the following aspects of the warning notice regime:

- *in relation to a draft warning notice*:
    - section 153L provides that the ACCC "*may*" provide a draft public warning notice to a corporation. AGL's view is that a public warning notice cannot be issued pursuant to section 153M unless this draft notice has been first given to the relevant corporation;

[20] ACCC, *Inquiry into the National Electricity Market – August 2019 Report*, August 2019, page 35.
[21] ACCC, *2019 Compliance and Enforcement Policy and Priorities*, February 2019, pages 2 to 3.

- the ACCC should identify the factors it will consider in deciding whether there has been detriment suffered and whether it is in the public interest to do so; and
- while a corporation has 21 days to make representations to the ACCC, there should be opportunity once those representations are made for a corporation to engage with the ACCC. There is at least two months for this engagement to take place after the ACCC gives a corporation a draft notice as section 153M allows for a public warning notice to be issued within 90 days after the draft notice. This engagement is important given that considerable commercial detriment can be suffered by the recipient of a notice; and

- *in relation to the both the draft warning notice and public warning notice*, it would assist if the ACCC could clarify:
  - whether the public interest is to be a balancing test – that is, in determining the public interest, will the ACCC weigh any public interest in publishing such a notice as against the potential detriment that may be suffered by the corporation? For example, the advisory notice process in Part XIB of the CCA requires that the ACCC be satisfied that the public benefit would outweigh any substantial prejudice to the commercial interests of a person that would result if the advisory notice was published (subsection 151AQB(8) of the CCA); and
  - what factors will result in no public warning being issued. For example, if a corporation has already remedied the alleged contravention or if there was a genuine error that resulted in a technical contravention of one of the prohibitions, there may not be any public benefit to be gained in issuing a public warning notice.

Prohibited conduct notices and recommendations

Section 153P of the Act provides that the ACCC may give a corporation a prohibited conduct notice in writing, recommending that the Treasurer or Court make a contracting or divestiture order if the ACCC reasonably believes that:

- the corporation has engaged, or is engaging in, prohibited conduct;
- the Treasurer or the Court making that kind, or those kinds, of orders is a proportionate means of preventing the corporation from engaging in that kind of prohibited conduct in the future; and
- if that kind of order is a divestiture order will result, or likely result in a public benefit.

The ACCC must then provide the Treasurer with a prohibited conduct recommendation or no Treasurer action notice (sections 153R and 153S).

Given the seriousness of the orders the ACCC can recommend, the ACCC's process must be robust and transparent and corporations affected should be given the opportunity to understand and test the evidence that the ACCC is relying on in recommending such a remedy.

In particular:

- a *prohibited conduct notice*, the immediate precursor to a prohibited conduct recommendation, should include the following:
  - the ACCC should disclose the material facts and contentions (i.e., the evidence) upon which the ACCC relies, in relation to the alleged prohibited conduct and why it considers the order(s) to be proportionate and likely to result in the public benefit. This will at least provide the corporation with an opportunity to identify any factual errors or inaccurate analysis, and make appropriate representations to the ACCC in response within the limited 45-day timeframe;
  - the 45 days should cease to run in the event there are material facts or contentions that have not been disclosed;

- for more complex allegations, the ACCC should provide a longer period for the corporation to make representations. The ACCC may do this pursuant to subsections 153P(2)(f) and (3)(b)(ii).

There should also be an opportunity to engage directly with the ACCC after submission of those representations so a corporation is able to respond to any outstanding questions or allegations the ACCC may still have; and

- if the ACCC decides to give the Treasurer a *prohibited conduct recommendation*, there is no requirement on the ACCC to give the corporation a copy of the recommendation – the ACCC only has to give the ACCC a copy of a no Treasurer action notice (section 153U). This appears to be a significant oversight in the Act given what comes after a recommendation, and AGL asks the ACCC to include in its Guideline confirmation it will accord with procedural fairness and provide a copy of the recommendation, and any supporting evidence, to the corporation.

4. Further guidance

Lastly, it would assist if the ACCC could explain how they see enforcement of Part XICA interacting with its other electricity industry monitoring activities, namely enforcement of the DMO Code and the Electricity Monitoring Inquiry.

Two specific clarifications that AGL considers market participants would be aided by are as follows:

- *ACCC use of compulsory notices to investigate market misconduct* – in investigating potential breaches of the Act, the ACCC should use its information gathering powers under section 155 of the CCA rather than section 95ZK notices issued within the context of the Electricity Monitoring Inquiry. This is because section 155 is an express power for the ACCC to obtain information, documents and evidence in relation to matters that may constitute a contravention of the CCA. The Act will insert a new Part XICA into the CCA and the ACCC may therefore issue section 155 notices where it has reason to believe there has been a Part XICA breach. Section 155 notices offer a greater degree of procedural fairness than a section 95ZK notice because:
    - section 155 notices provide a corporation with transparency as to what the ACCC is investigating as the ACCC sets out the matter(s) to which the notice relates; and
    - the section 155 notice process is confidential and there are certain protections afforded to information and documents produced in response to a section 155 notice; and
- *Compliance with the DMO* – the ACCC enforces compliance with the DMO Code, which requires retailers in regions where the DMO Code applies to ensure that their standing offers comply with the DMO price cap as calculated by the AER. The AER's DMO determination sets the reference price cap and model annual usage. It would assist if the ACCC could clarify the extent to which the ACCC may rely on the AER's determination and analysis in calculating the price cap in determining whether a retailer has complied with the retail pricing provision. As noted above in section 2.1, AGL's view is that the DMO (and the VDO) is not determinative of whether there has been a sustained and substantial reduction. A decrease to the DMO or VDO should be considered as indicative only.

Confidential Annexure A – Examples of conduct that should not be in breach of Part XICA

[Commercial-in-confidence]