AUSTRALIAN ENERGY COUNCIL

Electricity Legislation Consultation
Structural Reform Group
The Treasury
Langton Crescent
Parkes ACT 2600

Lodged by email: Electricity.Legislation@treasury.gov.au

21 November 2018

Electricity price monitoring and response legislative framework

The Australian Energy Council (the "**AEC**") has significant concerns about the transparency and adequacy of the consultation conducted by The Treasury on this critically important legislative change.

The *Treasury Laws Amendment (Electricity Price Monitoring) Bill 2018* (the "**Bill**") does not address the AEC's submissions in response to the Consultation Paper on 7 November 2018. There are serious unanswered questions regarding the constitutional validity of the Bill, as well as significant practical questions regarding its interpretation and operation.

We are genuinely concerned that, notwithstanding the Government's intentions, the approach set out in the Bill would produce negative impacts for all consumers by increasing perceived regulatory risk and accordingly increasing the cost of investment necessary for the market's further development. By contrast, it is not clear that the Bill will reduce electricity prices, reduce customer confusion, or operate as recommended in the Consultation Paper.

Inadequate consultation and lack of transparency

The AEC was provided with a copy of the bill marked "Limited Circulation" on the afternoon of Friday, 16 November 2018, with a deadline for any submissions by Wednesday, 21 November 2018. The Government appears intent on avoiding any further scrutiny on this policy, by only allowing key stakeholders, such as the AEC (notwithstanding that it is a representative body), three business days to provide feedback on the changes proposed.

The Government's request that the Bill be kept confidential is unusual and further indicates a desire to avoid scrutiny on an important legislative change. As you know, the AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses. Given Treasury's request for feedback relates to the "workability" of the legislation, rather than a question of policy, the need to seek views from our membership (who will be the ones complying with the legislation) is critical. The request not to share the draft legislation outside of the AEC, a membership based organisation, would mean we cannot seek views from the businesses we are entrusted to represent.

We understand confidentiality can sometimes be necessary when a matter remains subject to cabinet or national security concerns but that is not the case for this Bill. The Government has stated multiple times in the media that the legislation will be forthcoming in the next sitting fortnight. The AEC's strong preference is that this important policy debate be as public and transparent as possible.

Comments on the Bill

The AEC's submissions in response to the Consultation Paper raised a number of issues. These issues have not been adequately addressed in the Bill, and we continue to refer to the points outlined in our submissions.

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

Given the limited opportunity to review the Bill, we have provided only our key comments which are set out below.

Commercial impact of retail pricing provisions

The AEC is particularly concerned by the drafting of section 153D (prohibited conduct - retail pricing). The section appears to require an adjustment to the price of offers for small customers where there is a reduction in an electricity retailer's "underlying cost of procuring electricity". This key phrase is not defined, which creates significant practical uncertainties. For example, it is unclear when a retailer is required to make the reasonable adjustment (such as on a periodic basis, or when the retailer actually realises a reduction in its cost of goods).

It will also be very difficult to apply and enforce in practice. The cost of procuring electricity is a function of the cost of buying electricity from the fluctuating electricity spot market, and then hedging volume and price exposure through financial contracts (and other means) over time. A reduction in the electricity spot market for a period of time does not necessarily translate in to a reduction in the cost of procuring electricity, and so the Bill will expose the Government and ACCC to criticism that it is ineffective.

Certain interpretations of section 153D (which appear open based on its broad wording) would create a substantial interference in the market without an appropriate balancing of other factors which may be relevant to any decision to pass on underlying reductions (or increases) in costs. The Bill must acknowledge and accommodate the fact that wholesale electricity prices are only one part of a retailer's costs. If the Bill does not include other costs (such as risk, network costs and green schemes) in any formula for permitted pricing, this would create a perverse incentive for retailers to minimise investment in (and exposure to) such costs.

Further, the fact that retailers will be required to adjust prices to reflect reductions in the cost of procuring electricity means that retailers would have a strong incentive to increase prices in response to any other cost increases, and to price electricity higher to make room for future reductions, as there would be limited scope to recover lost margin due to other cost pressures when procurement cost reduces. The lack of clarity around the key term "underlying cost of procuring electricity" makes it increasingly difficult for a retailer to take risks and invest in new generation to reduce their electricity costs. If a retailer makes a sound investment the reduction in costs will be required to be passed through to consumers in full. No allowance for risk or losses can be recovered. This removes incentives for a retailer to take steps to try and 'beat the market', an outcome we should be encouraging. The unintended effect of the Bill may be to increase retail prices, not decrease them.

No protections for business

The Bill assumes the ACCC and Government will only utilise these provisions in instances of egregious behaviour. However, there are no real legal protections and no merits review for Government decisions. Consequently, when businesses (including, but not limited to foreign companies (such as the parent entity of one of our members)) are considering investing in generation or other opportunities, the mere existence of such powers (which have the potential to be utilised more regularly by future governments) weighs heavily on decision making and increases risks of, and therefore the required returns for, future investment.

Legal issues regarding validity

In determining whether to make an enforcement order, the Bill requires the Treasurer to determine whether he or she is satisfied that a contravention of the Bill has occurred, that an enforcement order is a proportionate means of preventing future contraventions, and (in the case of divestiture orders) that the order is likely to be in the public benefit. These decisions are judicial in nature and should not be exercised by the Treasurer

Further, enforcement orders can only be made in response to prohibited conduct by a corporation, and so must be characterised as a consequence of that conduct. In the AEC's submissions, we warned that there is a serious risk that this is the prohibited vesting of judicial power in the Treasurer and is unconstitutional. These concerns have not been addressed in the Draft Bill.

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

The AEC, like the ACCC and the AER, considers current market conditions do not require the heavy-handed approach that divestiture entails. We are genuinely concerned that that this approach could produce negative impacts for all consumers by increasing perceived regulatory risk and accordingly increasing the cost of investment necessary for the market's further development or, worse, discouraging investment.

It is also impossible to expect a corporation, forced to divest its assets, to achieve a fair and commercial sale (taking into account the nature of the corporation and the impact of the forced sale on its business). In our submissions, we noted this concern and flagged that divestiture orders may therefore be unconstitutional on the basis that they would require the acquisition of property other than on "just terms". These concerns have been acknowledged through the insertion of section 153ZC to the Bill, which does no more than highlight that such orders are of no effect. At best, section 153ZC seeks to require the High Court to rule on the invalidity of each divestiture order individually, rather than on the power as a whole and therefore might be viewed as an attempt to delay any Constitutional challenge to a later time. This is obviously an unsatisfactory outcome. It should go without saying that if those drafting the legislation are not sure where the appropriate boundary between the *Competition and Consumer Act* and the Constitution is, then more investigation is necessary.

The Bill does not address the AEC's concerns regarding the appearance of political interference in what appears to be judicial decision making. It also does not clarify whether Australian Government owned businesses may acquire assets required to be divested by the Treasurer. It does not address the fact that businesses face these orders in circumstances where the ACCC acts as both the investigator, and decision-maker, as to whether misconduct has occurred, and is only required to have a "reasonable belief" that misconduct has occurred before it is able to decide whether or not to recommend Treasurer intervention.

Leaving aside the AEC's reservations with the proposed policy itself, it is simply irresponsible to implement any new legislative scheme, especially one as significant as the Bill, in the face of known issues of constitutional validity, especially in an expedited time frame with limited consultation. Potentially invalid new laws create significant uncertainty and risk which can easily be avoided by a proper and transparent consultation process, including adequate timeframes for consideration.

Assuming the Bill is constitutionally valid, the AEC's submission that these extreme powers be subject to clear and objective criteria have not been addressed. Instead, many of the key criteria for enforcement turn on the ACCC's "reasonable belief" and the Treasurer's "satisfaction" (which, applying basic principles of statutory interpretation, need not be reasonable).

Compounding uncertainty with more uncertainty, the thresholds of "reasonable belief" and (subjective) "satisfaction" are applied to vague questions, including whether an order is a proportionate means of preventing future conduct. There is no guidance or clarity on how this proportionality will be assessed, or what level of future misconduct must be anticipated before these orders will be made. The fact that this is in circumstances where there is no formal finding of misconduct—only the ACCC's reasonable belief and the Treasurer's satisfaction—is profoundly unsatisfactory.

Drafting of this nature makes it impossible for businesses to assess the regulatory environment and will have a chilling effect on investment. The increased possibility of heavy penalties handed down from the Treasurer or the ACCC, without giving marking participants clear criteria for avoiding these penalties, will destabilise the market. It also makes avenues for administrative review unsuitable, as the tests to be questioned are too ambiguous to be critiqued.

The Bill appears to reflect the haste in which it was drafted and contains numerous other legal issues and uncertainties. This lack of clarity is made all the more significant in light of the enforcement powers contemplated by the Bill. Unfortunately, it is not possible to identify and respond to each of the drafting issues in the limited timeframe available for comment.

Next steps

The AEC requests that the Government carefully consider the submissions made in response to the Consultation Paper, and release a revised consultation draft of the Bill for broader public comment with a reasonable timeframe for review.

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

These proposed legislative changes are significant, and must be executed properly to avoid unintended outcomes. As an absolute minimum, it must be clear that the new law is constitutionally valid.

Any questions about this submission should be addressed to Ben Barnes, by e-mail to ben.barnes@energycouncil.com.au or by telephone on (03) 9205 3115.

Yours sincerely

Sarah McNamara
Chief Executive

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07