

29 January 2019

Senate Standing Committee on Economics
Australian Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018

Dear Chair,

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments (COAG) Energy Council in 2015, our objective is to promote the long-term interests of consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to comment on the *Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018* (the Bill).

High prices and significant and ongoing detriment being experienced by households and small businesses in a market for an essential service means that strong measures are reasonable. Poor outcomes for consumers for everyday services such as energy is also undermining their trust and confidence in competition and markets.

It is important to assure the community that if evidence of systemic misconduct does emerge through enhanced market monitoring, regulators, governments and the courts have the tools they need to respond. However, the rebuilding of trust and confidence ultimately depends on the actions of industry participants.

The Bill has been substantially amended since it was first tabled. It now contains a graduated and time-limited series of measures and checks and balances that in our view clears the way for private investment and competitive behaviour compared with the original draft.

The energy market is not working for consumers

While the issues around price and customer experience were well canvassed by the Australian Competition and Consumer Commission (ACCC) in its Retail Electricity Price Inquiry Report (REPI), new evidence continues to emerge about the challenges consumers across the board are facing that is worth reflecting on, because they go to the heart of the issues that have triggered a debate about the structure and performance of the energy market, and the pivot to consumers the energy sector needs to make.

We draw the Committee's attention to recent reports on two different groups of energy consumers.



The first is a joint report by Australian Council of Social Services (ACOSS) and the Brotherhood of St Laurence¹ that found that people on low incomes are now spending more than 6.4 per cent of their incomes on energy, up 0.5 per cent since 2008, and more than double what Australians on middle incomes are spending as a share of their incomes. The alarming levels of energy debt and disconnections being reported by the Australian Energy Regulator (AER) are a strong indicator that people are being left behind as energy claims a bigger and bigger share of household budgets.²

In *Close to the Edge*, the Public Interest Advocacy Centre (PIAC), shows that behind these affordability statistics are the everyday experiences of people living with the anxiety and stress about their energy bills, and in some cases, being forced to choose between a comfortable home, that doesn't put their health at risk, and putting food on the table.³

Of course, high energy prices are not just a problem for low income households, they are also an issue for many different types of consumers, including small businesses.

A recent survey by the Council of Small Business Associations of Australia (COSBOA) found that 85 per cent of small business respondents would struggle to absorb any future price increases, and 1 in 8 reported already being unable to pay their energy bills. A dairy farmer surveyed for the report described the relentless impact of high prices for an essential input like energy:

*"Basically, we just cut back on everything else around the farm and the household expenditure ... it's not like we can't [choose not to] cool the milk or clean the sheds – that's just not an option."*⁴

The evidence in these reports which show how high prices cause people and small businesses to lose control over their energy costs, are consistent with what we are hearing from consumers in our six-monthly Energy Consumer Sentiment Survey (ECSS) – the latest published on 18 December 2018. In the ECSS households and small businesses consistently rank electricity behind banking, insurance and mobile phone services on value for money, and less than half of consumers say they have the information and tools they need to make choices about energy services. Importantly for the debate about market structure and misconduct and the measures outlined in this Bill, only a third of respondents indicate that they believe the market is working in their interests.⁵

The ACCC identified significant problems across the entire supply chain that are contributing to bad outcomes for consumers and add up to what Rod Sims has said is a "market that is not working for consumers". Getting on with the job of refining and implementing the comprehensive package of 56 REPI recommendations must be the number one priority for governments – both individually and through the COAG Energy Council – to deliver promised savings of 20-25 per cent or \$400 off the average household bill.

¹ <https://www.acoss.org.au/wp-content/uploads/2018/10/Energy-Stressed-in-Australia.pdf>

² <https://www.aer.gov.au/wholesale-markets/compliance-reporting/quarterly-compliance-report-january-march-2018>

³ <https://www.piac.asn.au/wp-content/uploads/2018/11/PIAC-CTTE-Consolidated-Report-FINAL.pdf>

⁴ <https://www.cosboa.org.au/energy-project>

⁵ <https://energyconsumersaustralia.com.au/news/only-1-in-4-say-their-homes-are-energy-efficient/>



Special measures needed to restore trust and confidence in competition and markets

When systemic problems emerge in markets, the community expects governments to act to remedy them. This expectation is particularly strong in markets for essential services such as energy.

Importantly, the complexity of the problems in markets like energy are much wider than traditional Australian economic and competition policy. New approaches are needed to respond to what Paul Kelly has described as the ‘Great Australian Trust Crisis’:

“The public feels its lack of power. It wants to be enabled; at heart it seeks a more participatory form of service delivery. Its resentment at the oligopolistic and patronising nature of Australian corporate power – from retail to telecommunications to energy – is growing.”⁶

We acknowledge that industry leaders are responding to the trust challenge through the development of *The Energy Charter*. This is focused on embedding customer-centric culture and conduct in energy businesses to create real improvements in price and service delivery, through commitment to the five principles.⁷ The Energy Charter will address market conduct and as is appropriate for an initiative that seeks to go above and beyond the rules to focus on outcomes for consumers, participation is voluntary.

The persistently poor outcomes that Australian households and energy consumers and the resulting trust and confidence deficit help explain why new tools (including a time limited temporary court-ordered divestiture power) to prevent and remedy market misconduct are being considered by Parliament.

It also helps explain why the ACCC saw a role (albeit limited) for prices for a subset of energy offers to be set by the regulator to reduce complexity and risk for consumers who may not engage in the market in the way assumed in the market design. This complexity and risk is out of proportion to the time and capability consumers have to engage in energy, or any other market.

This is not a rejection of competition but a recognition that extraordinary measures may be required (even if only on a temporary basis) to stabilise and reset competitive markets. St Vincent de Paul echoed this sentiment in its latest National Tariff Tracker:

“In our view, it was not necessarily the idea of a competitive energy retail market that was bad. It was the execution.”⁸

Improving outcomes and salvaging the idea of a competitive market cannot be achieved through new law and regulation alone – it will require a big cultural shift to focus on delivering the best possible service for consumers, on their terms. This shift needs to be made by

⁶ <https://www.theaustralian.com.au/news/inquirer/the-nations-great-trust-crisis-hits-home/news-story/ac878b67aad9c78341c4ebc0bef2afbc>

⁷ <https://www.theenergycharter.com.au/>

⁸ https://www.vinnies.org.au/icms_docs/298264_2018_NEM_-_No_guarantee_for_consumers.pdf



boards and senior leadership teams of energy companies across the supply chain and by policy makers and market bodies in the sector. Recent action by the Big 3 retailers following the roundtable with the Federal Minister for Energy, including to improve concessions support for customers and to reduce prices for standing offer customers, is an important first step in this process. More significant price reductions, and longer-term initiatives like the Energy Charter, should create space for governments to resume a more normal oversight role.

Graduated and time-limited tools to address misconduct

The measures in the Bill provide a graduated framework of tools to deal with misconduct. In general, misconduct of the kinds identified in the Bill only occurs in markets with a small number of firms resulting in each having significant market power.

The ACCC found that market concentration across the NEM has increased in recent years due to the sale of government owned generation to incumbents, the restructuring of government-owned generation businesses and the closure of generation facilities owned by smaller market participants. Presently, the three most significant generators account for more than 70 per cent of installed capacity and more than 80 per cent of dispatched energy in all NEM regions.⁹

The ACCC found that spot prices in the wholesale market increased from an average of between \$42-66 (\$/MWh) between 2008-2014, to \$97-\$120 in 2017. This has contributed to much higher revenues, with earnings before interest and tax (EBIT) of seven of the largest generators almost doubling from approximately \$1.5 billion in 2015-16 to \$3 billion in 2016-17. In chapter 4 of its report, the ACCC found that market concentration is contributing to higher prices now, and increasing the risk that these high prices will be sustained, by frustrating the way the 'energy only' wholesale market is designed to work as:

- it allows generation businesses to optimise across their portfolio, not only to cover their retail or contracted loads, but also in some cases to “drive up prices in such a way as to advantage an entire portfolio”
- it reduces the incentive for incumbents to invest in new generation because additional supply is likely to lead to lower spot prices and revenues for their existing portfolios.

The ACCC found that fixing this core wholesale market mechanism was central to delivering (depending on the jurisdiction) up to \$200 in savings for the average household energy bill.

In the context of the Bill, the ACCC's recommendations to deliver these savings are largely prospective, including a cap on acquisitions, transparency measures for 'over-the-counter' trades, market liquidity measures, and underwriting new dispatchable generation. Additional recommendations to strengthen the hands of consumers in the retail market (where the major players are also the big generators) by re-establishing the price safety-net, clearing up

⁹ Page 44

https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf



confusing discounting practices, are estimated to deliver additional savings in the range of \$26-\$62.

That it was not able to identify specific instances of misconduct appears to have been influential in the ACCC opting to rely on these kinds of remedies. Ultimately, it is expecting new players entering the wholesale and retail markets which should, over time, reduce concentration and increase supply and competition.

The ACCC was clear however, that the design of the wholesale market and concentration created the potential for the exercise of market power, and it is possible that closer scrutiny of outcomes and behaviour being provided by the ACCC Electricity Price Monitoring Inquiry, as well as the AER's enhanced information gathering powers and process, may uncover evidence of misconduct. In the time since the Bill was drafted, the AER has published its first Wholesale Electricity Market Performance Report which also highlighted the potential for the misuse of market power but did not find evidence of 'short-term behaviour' contributing to higher prices.¹⁰ It did however identify some concerning anomalies:

*"[A]verage offers from some black coal generators in NSW and Queensland have increased due to the increase in coal costs. But the increase in coal costs alone does not appear to explain all of the increase in offers. Specifically, in Queensland average offers have increased significantly despite some evidence of a slight reduction in average coal costs. In addition, we identified issues related to participant conduct in South Australian frequency control ancillary services markets, but it seems unlikely these issues will be sustained as new participants have entered the market and the requirement for additional local services has been removed."*¹¹

A key consideration for the Bill is whether it is best to wait and see if clear examples of misconduct do emerge, and then make a judgement about whether the tools available to the regulators are adequate, or whether it is prudent to put them in place now, for exercise in future if needed on an overall public interest basis and even then only after companies have had myriad opportunities to explain or address any concerns. In ordinary circumstances we would opt for the former but given the seriousness of the problems confronting consumers and the market, we believe additional tools to protect consumers, providing they are designed and implemented in a careful and calibrated way, is warranted.

The Regulation Impact Statement (RIS) for the Bill also acknowledges that the generic provisions and remedies under the *Competition and Consumer Act* Cth (2010) are not adapted to the unique characteristics of energy as a service that you cannot choose not to consume and there are a range of difficulties in terms of consumer engagement (e.g. information asymmetry and lack of consumer support). This is consistent with the results of the Energy Consumer Sentiment Survey, which shows a significant gap between the numbers of consumers expressing an interest in engaging to get a better deal or to manage

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<https://www.aer.gov.au/system/files/Wholesale%20electricity%20market%20performance%20report%20-%20December%202018.pdf>

¹¹ Page IV,

<https://www.aer.gov.au/system/files/Wholesale%20electricity%20market%20performance%20report%20-%20December%202018.pdf>



their use, and those that then act on that interest, a dynamic that is not helped by the limited information and tools retailers make available to them.¹²

Much of the debate about this Bill has been the inclusion of Court ordered divestiture in the public interest as a remedy. We understand this is a last resort for the most aggravated and egregious behaviour and, exists only for one of the types of prohibited conduct (wholesale market) at the end of a graduated set of remedies that starts with a public warning by the ACCC, and progresses through multiple steps and has satisfied (in this sequence only) the ACCC, the Treasurer and the Federal Court of Australia:

“It is intended that divestiture orders would only be sought as a last resort, and subject to a Court finding a corporation has breached the aggravated wholesale conduct prohibition. The divestiture order power is a significant deterrent, and it may never become necessary to seek such an order.”¹³

The ACCC, the Treasurer and the courts are also explicitly constrained under the Bill to the use of remedies that are ‘proportionate’ and in the ‘public interest’ – these tests require the ACCC to have undertaken significant analysis, explored a range of other options and given the company the opportunity to respond to warning, infringement and prohibited conduct notices.

The Bill also sets the bar in terms of conduct at a level that energy companies should not find hard to clear. For example:

- The prohibited conduct provisions in relation to the retail market only apply where there have been ‘sustained and substantial’ reductions in supply-chain costs that have not been passed on to consumers.
- The prohibited conduct provision in relation to contract market liquidity only applies where it can be demonstrated that the company engaged in the behaviour with the *purpose* of substantially lessening competition i.e. not genuine risk management and hedging strategies.
- The prohibited conduct provision in relation to electricity spot markets only apply where it can be demonstrated that (at the very least), the company acted ‘fraudulently, dishonestly or in bad faith’ and, to unlock the remedies in relation to ‘aggravated’ cases, the *purpose* of the behaviour was to ‘distort or manipulate’ prices.

And in a circumstance where the ACCC did find evidence of prohibited conduct, we would expect that, consistent with the proportionality principle and good enforcement practice, the company would be given an opportunity to develop a plan to address the issue/s and mitigate the risk of it occurring in the future.

¹² <https://energyconsumersaustralia.com.au/publication/energy-consumer-sentiment-survey-findings-december-2018/>

¹³ Explanatory Memoranda page 90, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABEnergyMarketMiscon



It is also important that these measures are time limited, expiring on 1 January 2026 unless they were reviewed and a decision to extend is made by Parliament.

Conclusion

Thank you for the opportunity to comment on the Bill. Our hope and expectation is that market participants will continue with the constructive approach to rebuilding trust and confidence and there will not be a need to reach for these types of measures.

If you have any questions regarding our submission, please contact Chris Alexander on 02 9220 5500 or email on chris.alexander@energyconsumersaustralia.com.au.

Yours sincerely,

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