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DIVESTMENT POWERS FOR THE AUSTRALIAN ELECTRICITY MARKET – IS ITS BARK WORSE THAN ITS BITE?

The Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2019 ("**2019 Bill**") was [re]introduced into Parliament on 18 September 2019. If passed, the 2019 Bill will amend the Competition and Consumer Act 2010 ("**CCA**") and (amongst other things) introduce a divestiture power to force electricity wholesalers to sell a business or asset if they engage in certain pricing breaches. Divestiture powers in this context are unprecedented in Australia but they exist in other competition law jurisdictions including the UK.

This Alert notes that the new divestiture powers are relatively limited and in practice may be unavailable other than for repeat offenders where the Australian Competition and Consumer Commission ("**ACCC**") has already engaged in the lesser forms of punishment available. This Alert recommends that participants in the electricity market undertake regular compliance training if the Bill is passed to ensure their conduct does not fall within the scope of the new prohibitions.

Key issues

- The 2018 Bill lapsed before the Federal election in May 2019.
- The 2019 Bill was reintroduced into Parliament on 18 September 2019.
- The new divestment powers are claimed by Government to be in support of the ACCC's ongoing price monitoring enquiry into electricity prices.
- This Alert notes that the new divestment powers are relatively limited and in practice may only be used for repeat offenders where the ACCC has already administered lesser forms of punishment.
- Divestment powers in the electricity market are unprecedented in Australia but they exist in other competition law jurisdictions including the UK.
- Participants in the electricity spot market should make sure they have the relevant systems and compliance training in place to ensure they do not breach the new prohibitions and run the risk of being the first to company in Australia to be ordered to divest assets or shares.

2019 BILL – DÉJÀ VU

Certain prohibitions and remedies affecting the electricity market under the CCA were introduced into Parliament in an earlier version of the bill of the same name ("**2018 Bill**") but it lapsed before the Federal election in May 2019.

The 2019 Bill reintroduces these proposed prohibitions and remedies along with some relatively minor tweaks. With the Labor government signalling its support of the revised bill, the 2019 Bill is on track to be passed into law late this year.

NEW PROHIBITIONS

In summary the 2019 Bill proposes three new prohibitions under the CCA:

- **setting of retail electricity prices** – i.e., retailers engage in prohibited conduct if they offer or supply electricity to residential and small business customers without making reasonable adjustments to the price of electricity

offered or supplied to reflect sustained and substantial reductions in the retailer's underlying cost of producing that electricity;

- **purposes for which electricity financial contracts are offered (or not offered)** – i.e., generators (including the vertically-integrated gentailers) are prohibited from refusing to offer financial contracts (where they have the ability to do so) with the purpose of substantially lessening competition in any electricity market; and
- **manner in which a generator makes bids/offers electricity into the electricity spot market** – i.e., a generator engages in prohibited conduct if it (a) either bids or fails to bid to supply electricity on an electricity spot market, and (b) acts fraudulently, dishonestly or in bad faith in making this bidding decision and/or (c) for the purpose of distorting or manipulating prices in the electricity spot market.

The main modifications from the 2018 Bill are:

- allowing for a transition period of six months in which to enable the ACCC time to develop guidelines and outline its enforcement approach to the industry as well as allowing business time to review and adjust their practices, if necessary, to comply with the prohibitions;
- clarifying that an electricity retailer's standing offers are not subject to the prohibition relating to the setting of retail electricity prices;
- providing that a divestiture order in relation to a state owned entity must require the divestiture to be made to another state-owned entity. This amendment is known as the Katter amendment to reflect his concerns that divestiture orders could become a vehicle for court-ordered privatisation of public electricity assets; and
- limiting personal liability for breaches to company directors, secretaries and senior managers, while excluding other more junior employees.

While the Government's initial consultation paper on the proposed changes, issued in October 2018, contemplated a divestiture process whereby the decision to order a divestiture would be finally determined by the Treasurer (rather than via the judicial system), this proposal did not make its way into the 2018 Bill (likely as a result of significant opposition from both industry and the Labor Government) and remains excluded from the 2019 Bill.

THE DIVESTMENT POWER

Substantive criteria

The much discussed divestment power is only available for an 'aggravated' breach of the third prohibition listed above, which is contained in new s153H of the CCA.

Section 153H is breached if a corporation:

- bids or offers to supply electricity, or fails to bid or offer to supply electricity, in relation to an electricity spot market; and
- does so fraudulently, dishonestly or in bad faith, for the purpose of distorting or manipulating prices in that electricity spot market.

The s153H aggravated breach requires the conduct to satisfy *both* the 'bad faith' limb *and* the 'price distortion purpose' limb, while a 'basic' breach (contained in s153G) only requires *either* the bad faith *or* price distortion limb

to be made out. Divestment recommendations are not possible for 'basic' breaches.

Section 153G and H are similar to the National Electricity Rule 3.8.22A which prohibits offers, bids or rebids which are false or misleading.

An example of a s153H breach, which would also appear to be a breach of Rule 3.8.22A, is given in the Explanatory Memorandum to the 2019 Bill ("**EM**"):

Generator E makes a very low bid price on the spot market, discouraging other generators from bidding for the dispatch period, and then rebids at a significantly higher price just before the dispatch period but at a time when other generators are now unable to respond because of having already made relevant operational decisions in response to the original bid.

It appears that, in the absence of a robust and legitimate explanation for the rebid, the above behaviour will be taken to have the requisite bad faith character and market distorting purpose. The EM notes that the 'purpose test' is an objective assessment of the substantial purpose of the corporation having regard to all the facts and circumstances.

By contrast, the EM notes that a decision by an operator of three power plants, which make up a significant amount of available capacity in a network region, to take one of its plants offline for some discretionary maintenance on a day of particular high demand for electricity is likely to be a basic breach only (and therefore not subject to the divestment regime).

It also appears that the main bidding practice that the ACCC found to be occurring in its June 2018 Final Report on the Retail Electricity Price Inquiry (and which it found to be a significant factor in the increasing electricity prices) – i.e., the practice of lower cost coal generators bidding up to the levels of the higher cost gas generators due to a lack of lower cost supply competition – would *not* be a breach of either of the prohibitions.

This would appear to align with the ACCC's acknowledgement that such bidding practices are more in the nature of commercially opportunistic behaviour enabled by the lack of competition in the market, and a product of the National Electricity Market design itself (which design encourages the increase of prices in times of supply scarcity to signal for new generation investment), than a breach of any industry or competition law rules.

Procedural criteria

If the ACCC believes that a company has engaged in the s153H conduct described above, it has a range of remedies available to it. The divestment remedy is the last one in this range and is itself subject to a proportionality requirement. This is likely to mean that, in practice, it may not be used until all other available remedies are exhausted and the relevant company is still engaging in the prohibited conduct.

That is, in addition to:

- believing a corporation has engaged in the relevant prohibited conduct,

the ACCC must also:

- believe that the making of a divestment order by the Treasurer or the Court "is a proportionate means of preventing the corporation, or any related body corporate, from engaging in that kind of prohibited conduct in the future"; and

- is likely to result in a net benefit to the public.

Once the above criteria are met, the ACCC may recommend that the Treasurer apply to the Federal Court for a divestiture order. The Treasurer can only make such an application if it is also satisfied in relation to the above three factors (and meets certain timelines).

The Federal Court is then also required to find that the conduct engaged in is an aggravated breach of the relevant wholesale prohibition and that a divestment would be a proportionate remedy before it can make the divestiture order.

CONCLUSION

Despite concerns of some in the industry, the ultimate form of the 2019 Bill reveals a relatively limited set of powers.

This is even more so when compared to divestment powers in other jurisdictions, such as the UK's Competition and Markets Authority's (**CMA**) power to order divestments where found necessary to fix structural issues in a market which result in 'adverse effects on competition'. These powers are available to the CMA even where there has been no breach of any laws by the market participant being ordered to divest. For example, the CMA (or its predecessor) had ordered divestments in three industries[1] as a result of market investigations showing structural features (e.g. excessively high levels of concentration) in the market preventing them from functioning well and causing consumer detriment.

The new Australian divestment power is limited to very specific and, presumably, rare instances of certain prohibited conduct, and in practice may be unavailable other than for recidivists where the ACCC has already engaged in the lesser forms of punishment available.

Despite the above, it goes without saying that participants in the electricity spot market need to ensure they have the relevant systems and compliance training in place to ensure they do not breach the new prohibitions and run the risk of being the first company in Australia to be ordered to divest assets or shares. In light of the allowance of a six month transition period, the ACCC is unlikely to look kindly on companies that breach the new rules.

For further information or compliance advice, please don't hesitate to contact us.

[1] Including the Aggregates, Cement and Ready Mix concrete market, the private healthcare market and the London airports market. No divestments were recommended as a result of the CMA's market investigation into the retail energy market.

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