



EnergyAustralia

20 June 2014

Prof. Ian Harper
c/o Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

Dear Professor Harper

EnergyAustralia submission to Competition Policy Review Issues Paper

EnergyAustralia welcomes the opportunity to make a submission to the Competition Policy Review Issues Paper.

Energy Market Challenges

The review comes at an opportune time as the energy sector experiences a series of challenges created by falling demand and unparallel growth in embedded generation caused by a 5-fold increase in solar photovoltaic (PV) installations. This is further compounded by increasing network prices driven by inefficient investment in monopoly infrastructure.

With the emerging development of storage technology, the decision of the future will be on-grid versus off-grid electricity. This represents a fundamental shift in the competitive dynamic of the electricity market going forward, which calls into question the appropriateness of existing regulatory frameworks, including competition laws.

These factors, when combined with a highly competitive market, have led to a generation sector which is struggling to realise an adequate return on its investment and looking for options to respond.

The long term natural solution to these challenges is closure and/or consolidation in the pursuit of greater efficiency across the industry. This is necessary given the capital intensive and lumpy nature of investments. However, decisions by the Australian Competition and Consumer Commission (ACCC) to refuse mergers and acquisitions on competitive grounds hinders this very solution, and fails to consider the long term interests of consumers and the need for efficient investment in the long term.

The position of the ACCC and other institutional barriers fail to account for the current challenges in the generation sector and consider how the dynamics in the NEM are changing as embedded generation continues to grow and the reliance on the grid reduces.

This will ultimately be a long term disbenefit to consumers as efficient investment signals are reduced which will, at best, increase wholesale electricity prices or, at worst, threaten the reliability of supply.

In addition, Australia's gas markets continue to be challenged by a lack of transparency and liquidity in upstream supplies caused by an ongoing reliance on long-term contracts. These challenges are further complicated by a lack of consistent, evidence-based regulatory frameworks across the east coast as governments continue to respond in an ad hoc fashion to resource development.

It is important that policy makers, governments and the ACCC tackle these complex issues now and begin the dialogue on how a sustainable and competitive energy markets can support investment into the future.

Finishing the Reform Process

This review follows a decorated history of competition reviews in Australia with the first one – the Hilmer Review – underpinning much of the current structure of the energy sector. Whilst many of the reforms of the Hilmer Review (and subsequent reviews) have been implemented effectively, many remain unfinished which create costly market distortions and barriers to competition. The list includes:

- Privatisation of government-owned energy assets;
- Inconsistent energy retail regulations;
- Duplication and inefficiency in wholesale and retail regulatory frameworks;
- Application of third line forcing provisions; and
- Inconsistency in interpretation of joint venture defences.

The Review Panel is encouraged to consider these issues to ensure that both the retail and wholesale energy markets are able to operate in the most efficient and competitive manner to deliver long term benefits to consumers.

Network Reform

Network tariff and regulatory reform are both critical and urgent to ensure the productivity of the energy sector can improve and price pressures on customers are kept in check. Network costs make up over half of a customer's energy bill in most regions other than Victoria and the ACT. Regulatory reform is necessary to ensure only the most efficient costs are passed through via cost reflective network charges. This will reduce the existing cross subsidy between solar customers and non-solar customers and help reduce peak demand growth.

Furthermore, the Review Panel should consider the role of governments and the performance of regulators to ensure they do not act as a barrier to effective competition and impose unnecessary regulatory burden on businesses.

Should you wish to discuss any part of this submission I can be contacted on (03) 8628 1185 or lee.evans@energyaustralia.com.au.

Regards

Lee Evans
Policy & Advocacy Manager

1. Introduction

EnergyAustralia is one of Australia's largest energy companies, supplying gas and electricity to over 2.7 million household and business customer accounts. We own and operate a multi-billion dollar portfolio of energy generation and storage facilities across Australia including coal, gas and wind assets; controlling the largest privately owned generation fleet in Australia. Our generation portfolio of 4,646MW spans the National Electricity Market (NEM) with facilities in New South Wales, Victoria and South Australia generating over 26TWh during 2013, supplying approximately 15 per cent of the energy consumed in the NEM.

EnergyAustralia supports its current and future portfolio requirements through its mining operations at Yallourn, ownership of the 22 PJ Iona gas storage facility, a variety of stakes in upstream coal and gas developments and a range of short and long term fuel contracts.

2. Competition in the Energy Sector

Whilst the energy sector is largely regulated by its own regulatory framework, the *Competition and Consumer Act (CCA)* sits above this and influences the structure of industry and actions of market participants. The myriad of energy-related regulatory instruments (State/Territory and Federal) create a complex, and sometimes conflicting, set of obligations for businesses to comply with.

2.1 Market sustainability

The National Electricity Market (NEM) is evolving rapidly. 15 years after its creation changing market conditions, exacerbated by regular policy interventions by successive Governments (Federal and State/Territory), have pushed the NEM to breaking point.

Annual demand in the NEM has declined by 10,000 GWh since 2009¹. This is the result of a number of factors, including reduced industrial use in the economy, an increase in the penetration of solar PV generation and a reduction in household consumption as a result of increasing prices. Price increases have largely been driven by increasing network costs resulting from inefficient investment in monopoly infrastructure.

The decline in demand has been further compounded by an influx of renewable generation supported by the 20% Renewable Energy Target (RET). In an 'energy only' market the spot price informs efficient investment and operational decision. The RET provides an external subsidy that inefficiently distorts price signals and production decisions. As a result, this imposes a large direct subsidy cost on consumers.

These factors, when combined with a highly competitive market, have led to a generation sector which is struggling to realise an adequate return on its investment and looking for options to respond. The current response from generators is to reduce operational costs – primarily through reducing spending on non-essential maintenance. Furthermore, high capital costs and sector fragmentation, caused by the disaggregated structure of the energy sector, further complicate industries' ability to respond quickly to changing market dynamics.

Sustained inadequate returns are testing confidence in the current market design and could threaten the reliability of the sector. This can only be to the detriment of consumers in the longer term.

¹ Australian Energy Market Operator, *National Electricity Forecasting Report*, November 2013, p.3

2.2 *The emergence of distributed generation*

Over 1.2 million Australians – or 1 in 10 households - now have solar photovoltaic (PV) systems on their roof. The number of households and businesses investing in solar PV has increased 5-fold since 2011 with almost 3000MW of installed capacity in the NEM at a rate of approximately 64MW a month. The size of systems being installed is also getting larger.

This rapid increase has been fuelled by overly generous feed-in tariff schemes, network tariff structures and significant falls in the costs of solar panels. Rising electricity costs, primarily driven by uncontrolled network costs, have also encouraged people to turn to solar PV as a means of reducing their bills.

With advances in storage technology and continued improvement in solar panel technology, consumers of the future will have greater choice between on-grid and off-grid electricity supply. This will represent a fundamental and continued shift in the competitive dynamic of the electricity market. This calls into question the appropriateness of existing regulatory frameworks, including competition laws and the ability of the institutions administering these frameworks to adapt to a rapidly changing environment.

2.3 *Meeting energy market challenges*

The long term natural solution to market sustainability challenges is closure and/or consolidation. The high fixed cost capital intensive and lumpy nature of investment in the generation sector and market structures, where prices trend toward the short run marginal cost of operating, the decision to close is challenging. Further any decisions that could lead to increased efficiency of operations and potentially drive greater productivity across the sector have been largely blocked by the ACCC to refusal on competitive grounds. This fails to consider the long term interests of consumers and the need for efficient investment in the long term.

Using the NSW NEM region as an example, the ACCC has formed the view that should AGL be allowed to buy the Macquarie Generation assets that AGL, Origin and EnergyAustralia would own approximately 70% of generation capacity and account for approximately 80% of output. It argues that this would reduce access to generation contracts for smaller retailers which would limit their ability to offer competitive retail products in NSW². However, this view both ignores the strong incentives for vertically integrated generation owners to sell market based contracts to all market participants, and undervalues the contribution from Snowy Hydro and Delta Coastal, competition from the interconnectors from Victoria and Queensland, and the choice of alternative supply from embedded generation now afforded to customers.

Further, the ACCC appear to have arbitrarily formed a view of the appropriate number of competitors in the market. Many industries in Australia operate effectively and competitively with just two large players (the domestic airline industry where Qantas and Virgin control over 90% of the market and supermarkets where Woolworths and Coles have 73% of the grocery market share). The electricity sector is far from this with several asset owners across a relatively small interconnected market.

The ACCC's consideration of the energy sector, and its established framework for assessing competition in the market, leave the electricity generation sector in a state of limbo – unable to consolidate and subject to significant barriers to exit. This continued position by the ACCC will continue to delay a natural market process that is

² Australian Competition and Consumer Commission, *submission to the Australian Competition Tribunal on Proposed Acquisition of Macquarie Generation by AGL Energy Limited*, 2014, p.4

required to ensure that investment in existing and future generation plant is timely and appropriate to deliver reliable, secure and affordable power to customers. Without a clearly stated change in position by the ACCC it may be necessary for Government to intervene to coordinate a process to ensure efficient withdrawal of excess capacity because cartel and collusions contained in the CCA prevent generators from doing this of their own accord.

These structural obstacles and institutional barriers to efficient withdrawal of capacity in the fragmented generation market across the entire NEM, when combined with policy uncertainty created by governments, may lead to sub-optimal consumer outcomes, including:

- Reduced reliability and system security;
- Continued investment in the wrong plant mix;
- Excess withdrawal in some jurisdictions and insufficient in others; and/or
- Stranding of new, clean generation resulting in increased carbon emissions.

EnergyAustralia recommends that the Review Panel consider the structural and institutional barriers that prevent efficient investment in the energy sector and recommend Government action to ensure sustainable market development.

3. Halted Reform Process Reducing Competition

The Hilmer Review was a key contributor to much of the structure we see in today's energy markets. Hilmer, and the subsequent Parer Review³, recommended the development of national energy markets, consisting of privately owned, structurally separated businesses with generation and retail segments competitively based. Both reviews highlighted the value of encouraging private companies to invest in public infrastructure and the benefits of national consistency under a streamlined regulatory framework.

Reforms to date led by energy Ministers from all jurisdictions has created a physically and financially joined electricity market covering eastern Australia. The same has not quite been possible in gas markets where liquidity and market transparency remain ongoing challenges.

It is disappointing that in recent years energy market reform has stalled and suffered from a political unwillingness to complete the reform process. This halt has ingrained or created new competitive impediments in energy markets which have prevented some of the extensive consumer benefits of the Hilmer and Parer recommendations from being achieved.

3.1 Gas Market Reform

Australia's east coast gas market has undergone significant transformation over the past 20 years, since the need for change was envisaged in 1991, however many of the original goals, such as transparency and liquidity, remain elusive.

Competition in retail markets for gas has emerged and short-term balancing markets have been delivered. However, increased price and volume uncertainty and the continued dominance of long-term contracts have increased the risks of operating in the domestic market. The tools for managing these risks have failed to develop and inefficiencies remain.

³ Parer, W., *COAG Independent Review of Market Directions 'Towards a Truly National and Efficient Energy Market'*, December 2002

Historically the ramifications of low levels of transparency and non-existent liquidity were minimal while the size of the east coast gas market was small and prices were low. However, as the size of the market triples due to the emergence of an LNG industry in Gladstone and the domestic market dynamics change, the consequences will be greater and more broadly felt.

Supporting continued exploration and development of gas resources and promoting greater transparency and liquidity in the gas market will ensure that an adequate level of competitively priced gas can be delivered on the east coast of Australia. The Victorian Gas Market Taskforce recommended that the Productivity Commission be tasked with such a review⁴.

Gas exploration and development currently suffers from a lack of consistent, evidence-based regulatory frameworks across the east coast. This inconsistency, coupled with frequent political interventions, has seriously undermined investment, particularly in New South Wales and Victoria where exclusion zones and fracking bans have been imposed. Exploration and development is best enabled by greater consistency across jurisdictions and increased efficiency in regulatory processes.

Based on the lessons from global gas market development, achieving greater long-term transparency and liquidity in the east coast gas market means that the role of long-term contracts in transportation and gas must diminish and the framework for transmission access and investment needs to be conducive to achieving this goal. To create an efficient gas market on the east coast EnergyAustralia recommends the following actions:

- The Commonwealth Government request that the Productivity Commission conduct a high level coordinated review of market design, gas market competition, the direction and structure of the existing trading and related financial markets, and the suitability of carriage models for pipeline regulation.
- The COAG Council on Energy lead the development of a consistent framework, which all jurisdictions adopt entirely, that adequately balances the economic need to develop new gas resources with community concerns about gas exploration and production which avoids unnecessary duplication and is delivered through efficient best practice regulation.

Further discussion on Gas Market Reform is presented in our submission to the Eastern Australian Domestic Gas Market Study⁵.

3.2 Privatisation of Government assets

Central to the National Competition Policy reforms of the 1990s were incentives by the Commonwealth to jurisdictional governments to privatise public infrastructure. The Hilmer Review noted that

Historically, government-owned businesses have lagged behind their private sector counterparts in terms of efficiency. In the case of rail, electricity, water and gas utilities, for example, the Industry Commission has identified opportunities for increasing GDP by over 2%, or \$8 billion per annum⁶.

To date only Victoria and South Australia have privatised the full suite of assets.

⁴ Victorian Gas Market Taskforce, *Final Report and Recommendations*, October 2013

⁵ Copy of submission available at <http://www.energyaustralia.com.au/about-us/what-we-do/reports-and-presentations>

⁶ Committee of Inquiry into a National Competition Policy, Parliament of Australia, *Report by Independent Committee of Inquiry into a National Competition Policy*, 1993, p.169

The NSW Government is currently undertaking an electricity asset sale process with generation assets expected to net the Government up to \$6.5 billion. It is expected that the sale of transmission and distribution assets, valued at \$29-34 billion, will be a key issue in the next state election. The Queensland Government, with an approximately \$40-48 billion electricity sector portfolio, has also flagged the potential for privatisation of its remaining retail and generation assets and the involvement of the private sector in refinancing the debt on existing network infrastructure and involvement in future expansions. While in Western Australia, the Northern Territory and Tasmania privatisation of electricity sector assets are not currently envisaged, further market and industry reforms are ongoing. This highlights the piecemeal and uncoordinated fashion with which privatisation has been undertaken.

Government ownership of electricity sector companies creates a competitive distortion as publicly-owned generators have lower capital costs by virtue of their higher credit ratings which are underpinned by Government ownership. Furthermore, a policy tension is created where Governments continue to own generation and network assets creating the potential to influence policy positions to the detriment of customers and/or taxpayers through unnecessarily high reliability standards or intervention in natural commercial processes. The NEM has developed as a robust market with significant private investment and Government policy has the ability to significantly shape how investment is made.

EnergyAustralia supports the financial incentives package currently offered to State/Territory governments by the Commonwealth to encourage them to privatise existing established assets and invest in new infrastructure. However, we are disappointed to see lease based and/or minority share sale arrangements being proposed by the NSW and Queensland Governments. These arrangements do little to remove the distortions or inefficiencies caused by Government ownership.

EnergyAustralia recommends that Commonwealth Government financial support for selling public assets be contingent on full privatisation. We also recommend that the Council of Australian Governments play a leading role in identifying public assets that would be improved through full privatisation. Examples in the energy sector include Snowy Hydro (and its retail arm Red Energy), Queensland generation, transmission and distribution assets and NSW transmission and distribution networks.

3.3 *The costs of national inconsistency*

The Hilmer Review noted that:

A national policy presents opportunities to progress reforms across a broader front, promote nationally consistent approaches and reduce the costs of developing a plethora of industry-specific or sub-national regulatory arrangements. It also presents important opportunities to increase the pace of reform, which is a question of considerable interest to businesses and consumers⁷.

Whilst this principle has been largely followed through implementation of the COAG Energy Market Reform process, some parts of the sector have suffered from jurisdictions opting out of competitive reforms leading to national inconsistency. This increases operating costs for businesses servicing multiple jurisdictions and reduces the consumer benefits made available through national consistency.

⁷ Ibid. p.13

The energy retail sector has suffered the most from national inconsistency. The National Energy Retail Law and National Energy Retail Rules were established in 2011 as the framework under which all jurisdictions would apply retail regulation. Since then it has been applied by NSW, South Australia, Tasmania and the ACT. Each jurisdiction has applied the framework with derogations which ingrains inconsistency between States/Territories. Victoria and Queensland are still yet to apply the national framework.

EnergyAustralia acknowledges the need to allow for jurisdictional derogations under limited circumstances but we consider that efficiencies are diminished with each variation from the standard framework. While preparing for transition to the national framework, EnergyAustralia was aware that jurisdictions might be tempted to derogate away from the standard framework to maintain unique features of their own regime and we have sought to engage with governments on this issue.

Rather than simply maintaining legacy aspects of the prevailing regime, a number of governments have implemented additional measures and EnergyAustralia consider that this practice is even more detrimental to efficient competition as it requires market participants to develop new systems and processes rather than simply maintain existing ones. This incurs expense which diminishes a retailer's capacity to discount and ties up resources which could be more productively used to develop innovative products and services to compete in the market. Specifically, the Queensland Government's proposed NECF derogations package features a number of additional obligations which have hitherto not been deemed necessary and their imposition does not in our opinion reflect good regulatory practice.

Furthermore, while the former Victorian Government was a strong proponent of the NECF in its early stages, the current Government still fails to implement it or announce a firm implementation date. Rather, it leaves industry in a period of uncertainty while it entrusts the regulator with the task of amending codes to largely align with NECF. This is a very unsatisfactory outcome when the original objective was to have uniform regulation across the NEM.

Further examples of national inconsistency reducing competition with regard to price regulation and metering are included in the Box 1.

EnergyAustralia recommends that the Review Panel highlight the barriers to efficient competition caused by national inconsistency and encourage the COAG Energy Council to have a greater focus on universal implementation of energy market reforms.

In addition, EnergyAustralia recommends that price regulation be removed in all contestable retail energy markets as this provides the best environment for creating efficient pricing and best supports the long-term interests of consumers and industry sustainability.

Box 1 – Case Studies of Regulatory Inconsistency

Price Regulation

Regulation of electricity and gas prices currently applies in Queensland, NSW (until 30 June 2014), ACT and Tasmania. State regulatory bodies makes annual determinations on the maximum allowable retail price for standing offer contracts. Retailers are able to offer market contracts in which retail rates may vary from the standing offer.

However, inevitably, a regulated price is seen as a benchmark price and if set at the wrong level, can have negative consequences for customers and the market. It is a difficult task for any regulator to set a regulated price in the market as they have imperfect information, must use transparent and predictable methods, and have to justify their approach to all stakeholders. Moreover, any form of regulatory uncertainty, particularly in relation to the future direction of regulated prices, inhibits the development of competitive markets by discouraging entry by new participants and investment by incumbents.

The appropriate structural arrangements are largely in place to ensure the removal of price regulation will increase competition, innovation and investment, and generate benefits for end use consumers. These benefits are broader than price and include improved choice and innovative products that suit customers' diverse preferences and profiles.

Metering

In 2008 the Victorian Government requested the AEMC, in accordance with section 91 of the *National Electricity Law* (the NEL), to make a Rule change to the National Electricity Rules (NER) by way of a jurisdictional derogation in connection with the rollout of smart meters into Victoria. This derogation was due to expire in December 2013 but has been extended for a further three years until December 2016. This effectively continues the monopoly distributor provision of electricity metering in Victoria which was not contemplated when the initial derogation was introduced.

Not extending the derogation would have allowed for competitive metering to be gradually introduced into Victoria much sooner to deliver greater customer benefits.

In order to support future competitive metering in jurisdictions other than Victoria, distribution companies (under their new and replacement policies) should not be encouraged to install 'smart ready' meters prior to a market led rollout. This will discourage competitive metering as it reduces the economies of scale of meter roll outs and increases existing asset base values that need to be recovered. Essentially, customers are forced to pay twice for smart metering.

While there is a positive trend towards national energy regulation there is also a disturbing overlay of secondary individual jurisdictional regulation such as new and replacement policies.

3.4 *Over complicated regulatory frameworks*

The energy sector experiences a significant overlay of regulation and scrutiny beyond that contained in the CCA. A recent assessment of EnergyAustralia's compliance obligations found that we are subject to approximately 9,000 separate regulatory obligations imposed through approximately 680 legislative and subordinate instruments.

This level of complexity and oversight is unnecessary and inefficient, and creates real costs for market participants and consumers. Box 2 includes two examples experienced in wholesale markets that highlight the challenges experienced by the energy sector. The first one on market power highlights the lack of evidence based regulation, whilst the second points to the over-regulation in the derivatives market. Both examples highlight regulatory complexity as a barrier to market entry.

At a time when State and Federal Governments are placing a high priority on reducing the burden of inefficient regulation, EnergyAustralia recommends the Review Panel consider the level of regulation in the energy sector and assess if it aligns with the initial competition policy principles of the Hilmer Review.

Furthermore, EnergyAustralia urges the Review Panel to publicly support our recommendation to the Commonwealth Government's Energy White Paper (Issues Paper) that:

- the COAG Energy Council provide the AEMC with an explicit mandate to review and reduce ineffective, duplicative, inefficient obligations and rules; and
- the National Electricity Law and National Gas Law should be amended to require the AEMC to test all new and amended rules against an objective of no net increase in regulatory burden.

EnergyAustralia supports good regulatory practice across the energy sector during all stages of the legislative cycle (i.e. problem identification, comparison of regulatory options, design, impact assessment, implementation, administration and post implementation evaluation) and considers that giving the AEMC this focus will improve the overall efficiency of the sector without reducing consumer and market protections.

Box 2 – Case Studies of Regulatory Burden

Rebidding Onus of Proof

Dynamic bidding and rebidding is essential to efficient dispatch and risk management in the NEM. Consultation is underway regarding a proposed change to the National Electricity Rules that would severely restrict the ability to efficiently bid and rebid generation capacity in a timely manner. The proposal seeks to reverse the onus of proof onto traders to show that any rebidding is done so in good faith [Ronnie/Ralph please correct if wrong]

Under the new rule proposed a trader working for a generator will be assumed to be guilty of an offence every time they bid or rebid unless they can prove otherwise with documentation sufficient to stand up to later judicial scrutiny. This burden of evidence is challenging when operating in a complex environment where professional judgment is often exercised.

In 2002 the ACCC determined to allow rebidding with a condition market of monitoring that would assess the impact of rebidding activity. The ACCC concluded that the overall effect of such a proposal – to reverse the onus of proof – may be to deter new entry and legitimate rebidding, thus diminishing competition and exacerbating the

problem it was intended to solve. This logic is enduring and there is no rationale to revisit proposals to further restrict bidding. The fundamentals of an efficient market have not changed since this issue was last reviewed. With more than decade of information available no material problem has been identified.

Electricity Derivatives Market

The stable and efficient operation of the electricity market relies on the use of financial contracts (derivatives) to reduce volatility, manage participant risk and provide appropriate investment signals. Financial contracts play an essential role in the NEM due to its design, and support stability and efficient risk management in all commodity markets. Regulations that impose costs and restrictions on financial contracting in commodity markets will generally increase risk and reduce market stability, transparency and liquidity.

At the 2009 G20 Pittsburgh Summit, the Australian Government joined other jurisdictions in committing to substantial reforms to practices in over-the-counter (OTC) derivative markets. These changes provide a framework for the regulation of OTC derivatives reporting, clearing and trade execution. EnergyAustralia understands there may be a case for the implementation of these reforms for key systemically important financial markets and institutions to provide international consistency. However, the Australian implementation has extended well beyond these areas to impose onerous obligations on commodity markets that are likely have a negative impact on the development of these markets with no benefit for financial market stability.

Whilst a temporary exemption from the framework for energy commodities has been put in place, it should be made permanent so as not to impose an unnecessary burden on generators (for little gain) and act as barrier to market entry.

3.5 Third line forcing

Section 47(1) of the CCA provides that a corporation must not engage in the practice of exclusive dealing. Sections 47(2) to (9) define instances of exclusive dealing. For the majority of instances, section 47(10) provides that the conduct is only prohibited if it has the purpose, effect, or likely effect of substantially lessening competition. However, this competition test does not apply to sections 47(6) and 47(7), which prohibit a corporation from selling goods or services, or giving a discount, to a person on condition that the person acquires goods or services from a third person. As the law currently stands, third line forcing is prohibited outright, regardless of its effect on competition.

Both the Hilmer⁸ and Dawson⁹ reviews recommended that third line forcing be subject to a competition test. This recommendation was never implemented, although the Act was amended in 2006 to include an exemption for related bodies corporate¹⁰.

Third line forcing can be notified to the ACCC in order to gain immunity. In assessing the notification the ACCC is able to consider the public benefits and detriments flowing from the conduct. Immunity commences 14 days from lodgment unless the ACCC objects.

⁸ Committee of Inquiry into a National Competition Policy, Parliament of Australia, *Report by Independent Committee of Inquiry into a National Competition Policy*, 1993, page 49.

⁹ Committee of Inquiry for the Review of the Trade Practices Act, Parliament of Australia, *Review of the Competition Provisions of the Trade Practices Act*, 2003, page 131.

¹⁰ Trade Practices Legislation Amendment Act (No.1) 2006.

In 2013, over 460 notifications were lodged with the ACCC and allowed to stand¹¹. A large number of these notifications related to customer discount offers and loyalty programs. In many instances, conduct which amounts to third line forcing will have no substantial anti-competitive effect. In fact, it can be pro-competitive and beneficial to the consumer. The combined administrative task of preparing, lodging, reviewing and paying for third line forcing notifications must surely outweigh any benefit to maintaining a per se prohibition.

EnergyAustralia supports the recommendations of the Hilmer and Dawson reviews to make third line forcing subject to a competition test.

3.6 *Joint venture defences*

The CCA contains a number of defences that apply where parties are engaged in a joint venture. These include the section 44ZZRO and 44ZZRP exemptions that apply in respect of the cartel offences, the section 76C exemption that applies in respect of exclusionary provisions, as well as numerous exemptions applying to the price signaling provisions.

These exemptions are not uniform. For example, the section 76C exemption applies to a contract, arrangement or understanding that contains an exclusionary provision if it is for the purposes of a joint venture and does not substantially lessen competition. In contrast, the section 44ZZRO and 44ZZRP exemptions apply only to a contract containing a cartel provision if it is for the purposes of a joint venture, and is for the production and/or supply of goods or services. The exemption applies to arrangements or understandings to a limited extent, but only in so far as the parties intended and reasonably believed that the arrangement or understanding was a contract. In relation to the price signaling provisions, the joint venture defence expressly extends to proposed joint ventures.

EnergyAustralia would welcome greater clarity and consistency around the joint venture defences. The Dawson review recommended that the ACCC develop and issue guidelines outlining its approach to joint ventures. Such guidelines would certainly assist the industry, but a more detailed consideration of the underlying principles and drafting of the joint ventures defences may be warranted.

In particular, EnergyAustralia considers that the section 44ZZRO and 44ZZRP exemptions are cumbersome in so far as they require the relevant cartel provision to be written into a contract. This requires companies to ensure that all potential cartel provisions, across a range of legitimate joint venture activity, form part of the contract itself. As the exemption is currently drafted, subsequent arrangements between the parties, which are for the purpose of the joint venture and contain a cartel provision, may not be covered. Nor is it clear that the exemption would apply where parties are negotiating a prospective joint venture and have not yet signed a contract.

EnergyAustralia also considers that legitimate and pro-competitive joint ventures can exist outside of the context of production and/or supply of goods and services. Accordingly, the section 44ZZRO and 44ZZRP exemptions should be expanded to cover joint acquisitions of goods and services.

¹¹ ACCC, *Notifications register, Browse by year, 2013*, <http://registers.accc.gov.au/content/index.phtml/itemId/1107038?statusfield=Allowed+to+stand>, accessed on 2 June 2014.

4. Inefficient Network Pricing

Network tariff and regulatory reform are both critical and urgent to ensure the productivity of the energy sector can improve and price pressures on customers are kept in check. Network costs make up over half of a customer's energy bill in most regions other than Victoria and the ACT. Regulatory reform is necessary to ensure only the most efficient costs are passed through via network charges.

4.1 *Embedded generation*

As discussed in section 2.2, solar PV penetration in the NEM has increased rapidly over the last decade to point where the choice of the future will on-grid versus off-grid electricity. On-grid electricity currently operates at a competitive disadvantage to embedded electricity options. This is because the costs of network infrastructure are shared between fewer customers as solar PV users become self-sufficient when the sun is shining. However, when the sun is not shining solar customers rely on grid electricity to service their home or business. Solar customers are effectively using the electricity grid as a safety net when the sun is not shining without paying for the privilege. This arrangement leads creates the inefficient building of network infrastructure and reduces the productivity of the network sector.

To address this network inefficiency EnergyAustralia recommends that network tariffs for all customers are transitioned over time to a cost reflective level to enable on-grid electricity to compete on a level playing field with embedded electricity supply options. This will ensure that solar customers pay the fair costs associated with maintaining the network they use as a back up when the sun is not shining. The regulatory framework should also promote efficient network investment more broadly and perverse incentives removed. For example, demand forecasts should be provided by independent parties to ensure customers do not have to pay for past over investment by Government-owner network companies that were responsible for forecasting demand.

5. A Defined Role for Government and Regulators

The energy sector is facing significant upheaval as it experiences a supply transformation whilst the traditional role for energy providers also changes as customers become self producers. As discussed earlier, growing distributed generation and the expected increase in energy storage and electric vehicles will test existing structures and could threaten the sustainability of the current market design. Governments' role in the energy sector is to ensure energy market structures remain sustainable and support what is likely to be a complex transition. In the short term, it remains important that the policy settings are focused on sustainable outcomes to ensure that the transformation of the energy sector is smooth.

Regulators also play a role in ensuring policy is implemented in the most effective and efficient manner. There are numerous examples of poor regulatory practice within the energy sector, including:

- redundant and duplicated information obligations;
- excessive reporting requirements and unclear rationale for information obligations; and
- inconsistencies in regulatory parameters and administration (including advice on how to comply or interpretation of obligations), either within a regulatory agency over time, or between different regulators and jurisdictions.

Regulators should be regularly held to account and assessed in a consistent manner. EnergyAustralia recommends that the Productivity Commission's *Regulator Audit Framework*¹² be applied to all Commonwealth and jurisdictional regulators to assess process and performance. The assessment should also consider regulatory activity across regulators to minimise the potential for duplication and/or inconsistency.

Like policy makers, regulators should consider the transformation of the energy sector and adapt regulatory practices to accommodate the evolving dynamics of the market. This should include a focus on outcomes-based regulation to ensure competitive markets are able to effectively operate in cooperation with adequate consumer protections.

¹² Productivity Commission, *Regulator Audit Framework*, March 2014