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Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Submitted online: www.competitionpolicyreview.gov.au

Dear Secretariat

Competition Policy Review Draft Report

AGL Energy Limited (**AGL**) welcomes the opportunity to make a submission on the Competition Policy Review's Draft Report (**Draft Report**).

With a number of significant transitional changes in the energy industry underway, the "root and branch" review of Australia's competition laws and policies is timely and provides an opportunity to determine whether competition laws remain fit for purpose. However, AGL disagrees with several of the major reforms proposed in the Draft Report, as described in Attachment 1 and Confidential Attachment 2.

In particular, AGL strongly opposes the recommendations in the Draft Report proposing changes to:

- the misuse of market power test in s 46 of the *Competition and Consumer Act 2010*; and
- the process by which merger authorisation matters are made directly to and heard by the Australian Competition Tribunal (**Tribunal**).

We are uniquely well-informed and well-placed to comment on the Draft Report's recommendations regarding this Tribunal process because AGL is the *only* party to have had a merger authorisation matter determined by the Tribunal under the current process. We are the only organisation that understands first-hand the absolute imperative of the Tribunal being able to hear a merger authorisation at first instance.

AGL is also well-placed to comment on a number of others issues raised in the Draft Report, which touch many aspects of our business. We are one of the largest energy retailers and generators of electricity in Australia. We have investments in coal-fired, gas-fired, and renewable electricity generation and upstream gas exploration and production projects. On the retail side, AGL provides energy to over 3.8 million electricity and gas customers in Victoria, New South Wales, South Australia and Queensland.

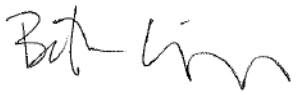
AGL believes in and supports vigorous and effective competition across all the markets in which it operates in order to benefit customers and market participants. Market structures characterised by competition and innovation, alongside efficiency in investment and expenditure, will best deliver these gains.

The key requirements for competition policy in the energy industry are:

- a principled and stable regulatory framework;
- specific and well-targeted regulation with the main purpose of preventing or rectifying sustained market failure;
- minimising the regulatory burden by eliminating unnecessary government and regulatory intervention in competitive, commercial processes;
- allowing free and fair market structures to evolve;
- requiring timely and transparent decision-making by regulatory bodies; and
- enabling due process for review of government and regulatory decisions.

AGL is happy to provide further information to the Secretariat on any issue raised in its submission. Please contact Kate Stoeckel on kstoeckel@agl.com.au or on (03) 8633 7816 or Angela Gregory on angela.gregory@agl.com.au or on (03) 8633 6817 if you have any questions in relation to AGL's position on these issues.

Yours sincerely,



Beth Griggs
Head of Energy Market Regulation

Enclosures: Attachment 1 (Public submission)

Attachment 1: AGL's public submission

"Effects" test for misuse of market power

The Draft Report's recommendation to introduce an "effects" test for the prohibition on misuse of market power is misguided and AGL strongly opposes this proposed amendment.

The Panel has not identified concrete legal or economic evidence which demonstrates any need for its proposed amendments. Despite 10 of 11 previous reviews of this issue rejecting an effects test (Draft Report Box 16.2), the Panel has adopted largely theoretical legal arguments in order to make an unjustified and radical case for change. This is not best-practice policy analysis.

The significance of this proposed change and its detrimental impact on business cannot be understated. The proposed reformulation of the test substantially broadens the scope for potential allegations of misuse of market power against large companies, based on the alleged effect on competition of the company's conduct – *even if* the conduct does not have any anti-competitive purpose.

The Panel's proposed approach effectively reverses the onus of proof – any conduct with the ultimate *effect* of substantially lessening competition would be prohibited unless both limbs of the Panel's proposed defence were established. The reason for this is that, rather than precisely identifying the harmful conduct that the Panel seeks to prohibit, the proposed change prohibits *any* conduct by such companies that ultimately has the effect of substantially lessening competition, but leaves companies accused of having breached this prohibition to demonstrate both that their conduct would be a rational business decision or strategy by a corporation that did not have a substantial degree of market power, *and* that the likely effect of the conduct was to benefit the long-term interests of consumers. Any company is likely to find it extremely difficult to establish to the required level of proof one, let alone both, of these proposed limbs.

The impact of the proposed amendments on large businesses and the broader economy is huge. On a day-to-day basis, this change would make it much more difficult for AGL to assess its risk of contravening the provision, as having a legitimate commercial purpose will no longer suffice. Instead, AGL would be required to consider the likely effect of its conduct not only on *competition*, but also on the interests of *consumers*. In some cases this analysis would be highly artificial, particularly in relation to AGL's upstream or wholesale activities, which are by definition remote from the end "consumers" of gas and electricity.

In order to comply with the proposed provision, AGL would need either to undertake detailed and costly analysis of the likely effect of proposed conduct, or to engage only in conduct which *clearly* raised no prospect of lessening competition. In either case, the impact to AGL's operations would be profound and widespread, with the likely result being either substantially increased compliance costs, or reduced pro-competitive conduct, including reduced investment, more limited offers for customers (large and small) with consequent higher costs, and significant curtailment of innovation. These would be industry- and economy-wide consequences; they would not be unique to AGL.

Under the proposed amendments, AGL would also be exposed to a higher risk of investigation and allegation of misuse of market power by the ACCC. This is because, if the ACCC took the view that AGL might have market power in a particular context, *any* substantial lessening of competition which might be said to have a connection with AGL's behaviour could be the subject of allegation or investigation. This is particularly so given that the two limbs of the defence will require complex analysis, and in most (if not all) cases will not be readily observable by the ACCC.

While the proposed effects test focuses on the effect on competition rather than on a single competitor, this does not solve AGL's concern, since it is clear from the ACCC's approach to mergers and other activity in the energy industry that it may well consider that harm to an individual competitor could constitute a substantial lessening of

competition. ACCC investigations based on theoretical concerns that are not substantiated in practice impose unnecessary and significant costs for all parties involved, and can entail unfounded reputational damage for companies along the way. By proposing a prohibition that is unjustifiably broad, and a defence that will be extremely difficult to establish, the Panel's recommendation would effectively encourage such investigations.

The current test should be retained. Importantly, this test only prohibits conduct which involves a "taking advantage" of market power – it does not prohibit conduct simply based on the co-existence of conduct that may substantially lessen competition and market power. As the current test requires a company with market power to have an anti-competitive purpose directed at a competitor, if conduct is therefore engaged in for valid commercial reasons, and not for anti-competitive reasons, then a corporation is not at risk of contravening the provision. The current test provides the day-to-day certainty required for efficient and competitive operations by allowing a business to assess its conduct by considering its purpose in undertaking the conduct, without requiring the business to undertake the complex, contentious and in many cases artificial analysis that the Panel's proposal would require.

Streamlined formal merger clearance process

Parties currently have three options for seeking comfort around their proposed mergers: informal clearance by the ACCC (with any injunctions or declarations reviewable by the Federal Court); formal clearance by the ACCC (decisions may be reviewed by the Tribunal on their merits); or direct authorisation by the Tribunal, such as sought by AGL with the Macquarie Generation purchase (review of a Tribunal decision is by the Federal Court). The Panel recommends this last merger authorisation avenue be removed in an attempt to "streamline" the formal processes. **AGL strongly opposes this change.** It would make the Tribunal a "review-only" body, as parties could no longer go directly to the Tribunal to seek merger authorisation.

The Panel's one-sided view of the role of the Tribunal in merger authorisations (ie as a review body only) has only sized up the "benefits" of making its recommended changes without considering the detriments to applicants under its proposed approach. And, as starkly demonstrated recently in the Macquarie Generation matter before the Tribunal, the detriments clearly outweigh the Panel's stated benefits.

It is critical to maintain the avenue of direct merger authorisation by the Tribunal so that a party challenging the ACCC's view can introduce new evidence to the Tribunal, as well as test the ACCC's evidence through cross-examination under oath. If the Tribunal became a review-only body, such as is being proposed, the Tribunal would only be able to consider those documents already created and previously submitted to the ACCC.

However, AGL's experience in merger clearances is that the ACCC does not always provide the applicant with complete information regarding the evidence it is relying upon or the issues that it considers may result in a competitive detriment. The current process does not compel the ACCC to provide such transparency. Without this level of transparency, the changes the Panel proposes would put the applicant at a significant disadvantage to the ACCC when seeking review of an ACCC decision by the Tribunal, as the applicant will have no idea of what "evidence" the ACCC has – it will only be able to rely on the ACCC's correspondence and public announcements when trying to assess the grounds of dispute. Applicants simply do not have the opportunity to refute the ACCC's "evidence" unless they can directly put new evidence forward to the Tribunal and have the ACCC's evidence tested (including by the Tribunal itself) in that forum.

AGL's recent success in the Macquarie Generation matter illustrates how critical it is for applicants to be able to introduce new evidence before the Tribunal when dealing with a prejudicial case theory held by the ACCC. AGL had limited understanding of the issues that the ACCC deemed would result in a competitive detriment prior to the ACCC's rejection of AGL's application for informal clearance, and AGL's subsequent application to have the matter heard by the Tribunal. It was imperative for AGL to have the opportunity to introduce evidence to refute the ACCC's claims in order to successfully repudiate the ACCC's theories of harm, as it successfully did. Examples of the Tribunal's findings of fact *vis a vis* the ACCC's theory of harm are set out for the Panel's review in

Confidential Attachment 2. Many of these issues would not have come to light if the Tribunal's hearing had involved a review of only the documents on record before the ACCC.

Regarding the informal merger clearance process, AGL supports the Draft Report's encouragement of the ACCC to review this process to deliver more timely and transparent decisions.

Recommendations: AGL Energy Limited submits that the Competition Policy Review should recommend that:

- The Australian Competition Tribunal should retain the ability to hear, at first instance, applications for merger authorisation.
- The Australian Competition Tribunal should have the ability to review all merger clearance decisions made by the ACCC under section 50 of the *Competition and Consumer Act 2010* (**CCA**).
- Any Australian Competition Tribunal merger clearance decision reviews or first instance merger authorisations should not be limited to a review on the papers before the ACCC.

Modified scope of cartel provisions

AGL supports the Draft Report's following amendments to the cartel provisions:

- *Competing firms*: changing the definition of competitor, to make clear that the cartel prohibition only applies to conduct between actual competitors in a market, and not firms "for whom competition is a mere possibility". This is a positive step away from the current law, and will make it clearer for AGL to assess who its competitors are for the purpose of the cartel provisions.

- *Joint ventures*: expanding the exemption from cartel conduct for joint ventures. The Panel's proposed changes will allow greater efficiencies and flexibility in joint venture arrangements, being particularly important in capital intensive sectors such as upstream gas. The Panel's proposed changes will reduce the current compliance burden associated with assessing whether legitimate collaborative conduct satisfies the highly technical joint venture exception. They will also reduce the costs to AGL of complying with this law, by allowing AGL to set out its joint venture arrangements in less formal documentation, including in operating procedures (which can evolve over time and are more flexible than written contracts).

- *Third line forcing*: introducing a competition test for all forms of exclusive dealing by suppliers and removing the per se prohibition. This change will ease the compliance burden associated with assessing whether conduct breaches the third line forcing prohibition, and the administrative burden of third line forcing notifications (which are infrequently required across AGL's business).

Concerted practices

AGL is concerned about the Panel's proposal to expand s 45 of the CCA (the cartel prohibition) beyond its current application to contracts, arrangements and understandings to also cover "concerted practices" that substantially lessen competition. Further evaluation is required before this proposed change is considered further.

Many business circumstances necessitate private disclosure of pricing information in the ordinary course of business, such as provision of pricing information to government agencies, price aggregator sites, and third party aggregators that market on behalf of AGL and other retailers. If this change is at all contemplated further by the Review Panel, a rigorous cost and benefit evaluation of the proposed changes is first required.

Greater thought needs to be dedicated to defining "concerted practices" so that the prohibition covers *only* the category of harmful conduct which is legitimately sought to be prohibited, and providing for adequate exemptions for ordinary, legitimate business practices.

Section 155 powers in ACCC investigations

AGL supports the Panel's recommended changes to the ACCC's existing s155 powers that allow it to require production of information and documents, but recommends that any changes be set out in the law itself rather than guidelines.

In relation to requiring Notices to be framed as narrowly as possible, in AGL's experience, poor s155 Notice drafting by the ACCC and an absence of consultation regarding that drafting has resulted in inquiries that are far too broad for the purported issue the ACCC wishes to investigate. This comes at no small cost. Set out in Confidential Attachment 2 is a relevant example.

In relation to the reasonableness defence, whereby "reasonableness" would be determined having regard to, for example, the number of documents involved and the ease of retrieving those documents, this should also be set out in the law itself. AGL takes compliance with s155 Notices extremely seriously, and its efforts to comply with various s155 Notices have been extremely onerous. As the penalties for non-compliance are severe, greater comfort would be obtained from this proposal if it were clearly implemented in legislation. It will provide little if any benefit, and will not achieve the Panel's objectives, if it simply has the status of an administrative guideline.

Regulation of the energy sector

Institutional reform

AGL supports the Panel's proposed creation of a separate national access and pricing regulator as set out in the Draft Report in order to ensure greater independence of energy regulatory matters, as well as the establishment of the Australian Council for Competition Policy.

Retail regulation

Retail price regulation and duplication of regulatory obligations across jurisdictions are significant sources of inefficient and unnecessary regulatory intervention in the retail energy sector.

AGL encourages, as does the Draft Report, retail price deregulation, as price regulation is destructive to the competitive process. In AGL's experience in contestable markets, retail price regulation actually *restricts* retailers from competing vigorously and delivering more diverse and innovative energy products and services. Rather, use of retail price monitoring instead would set up the right incentives for retailers to innovate through dynamic pricing structures and enhanced product offerings. Customers then benefit, as we would expect the increased product differentiation and innovation by retailers to be accompanied by a greater proportion of customers moving to innovative market contracts, as they are encouraged to take advantage of greater service offerings available in the market.

AGL also supports the Draft Report's recognition that the National Energy Retail Law needs to be fully implemented. AGL favours a national approach to energy regulation rather than separate State-based regimes which currently exist. The current system, in which energy retailers that operate nationally are required to comply with separate State-based obligations as well as various national obligations in jurisdictions that have implemented the National Energy Customer Framework is inefficient and expensive, and leads to increased administrative and compliance costs.

Privatisation

The Draft Report also recognises the benefits that would arise to the economy if remaining energy infrastructure assets were privatised.

Similarly, AGL considers that governments should transition out of the competitive retail and generation components of the energy supply chain. This would enable

governments to instead direct their capacity and resources towards non-competitive, public functions that, by their nature, require direct government involvement.

Gas transmission access

AGL supports the Panel's recommendation of a further, more detailed review of competition in the gas sector as proposed in the 2014 Eastern Australian Domestic Gas Market Study, and in the Federal Government's forthcoming Energy Green Paper.

It is AGL's current experience that extended regulation of monopoly transmission providers and gas transmission network pricing is needed. Even with increasing interconnection, the disparity of bargaining power between pipeline operators and shippers is leading to economically inefficient outcomes and negatively impacting market depth and liquidity. For liquidity to truly emerge, shippers require greater flexibility in access to pipeline services – such as renomination, redirection, backhaul transportation services, and services in the way of 'in-pipe trading'. In AGL's experience, pipeline operators do offer such services but often at prices that are not cost-reflective or on relatively inflexible terms which do not allow full optimisation by shippers.

The disparity of bargaining power arises because pipelines remain, practically speaking, monopoly infrastructure. Most pipelines are 'uncovered', and not subject to economic regulation. While coverage, or the threat of coverage, theoretically operates as a constraint to pipeline operators in their commercial negotiations with shippers, pipeline coverage is actually hard to obtain and, once obtained, tends to lead to an access arrangement with only limited scope. For example, operators of 'covered' pipelines have historically only been required to offer one reference service (typically a standard firm forwardhaul service), while the prices and terms for remaining services remain subject to one-sided bilateral negotiation. This inequality of bargaining power is exacerbated as shippers/retailers are generally tied to a pipeline, based on their long-term upstream gas supply decisions.