MEMORANDUM OF ADVICE

1. The Australia Institute has sought out advice in respect of the potential funding avenues available to the Commonwealth in respect of its proposed *Underwriting New Generations Investments Program* (**Program**). The Program seeks to reduce wholesale electricity prices via increased competition and supply in the National Electricity Market (**NEM**), and in particular by investment in new generation projects.

2. The NEM spans the eastern and south eastern coasts of Australia, and comprises five interconnected states (being Queensland, New South Wales (including the Australian Capital Territory), South Australia, Victoria and Tasmania). In brief, the physical infrastructure of the NEM includes the transmission network that carries power from electricity generators, the electricity distribution networks that reticulate power to consumer and the interconnectors between networks.

3. The market structure of the NEM, is a wholesale commodity exchange for electricity, supplemented by private contracts for electricity supply. Market generators that are classified as 'scheduled', offer to supply the market with specified amounts of electricity at specified prices for set time periods.[1] In addition there are 'semi-scheduled' generators, 'unscheduled' generators and distributed energy resources such as household solar that are not part of the generator scheduling system. The Australian Energy Market Operator (**AEMO**) decides which scheduled generators will be deployed to produce electricity, with (as a general proposition) the cheapest generator being put into operation first.

4. Both the NEM and the AEMO are products of various COAG resolutions and reforms (in particular, the Australian Energy Market Agreement dated 30 June 2004 as amended from time to time). The AEMO manages the NEM in accordance with the requirements of the *National Electricity Law* and the *National Electricity Rules*. Broadly, large suppliers in the NEM must be registered under the *National Electricity Rules* as a "generator".[2]

5. The Program arises in response to the findings of the Australian Competition and Consumer Commission's (**ACCC**) Retail Electricity Pricing Inquiry – June 2018. In essence, the ACCC found that the NEM was not operating in the best interests of consumers and that reforms were required – in particular the ACCC found that competition in the wholesale market was not working as well as it could, which in turn, affected electricity affordability.

6. A number of barriers to entry were identified in respect of investment into new generation sources, including the amount of upfront investment versus risk associated with the difficulty in predicting future wholesale electricity prices, particularly where customers have a distinct preference for shorter-term agreements (i.e. a developer would ordinarily seek to recoup its investment during the "locked-in" customer/retailer agreement time period, which would then necessitate a higher price per MWh, which in turn would be uncompetitive).

7. What this means, in a practical sense, is that it is difficult for independent generators (i.e. those without an existing generation portfolio and customer base) to enter the market.

[1] AEMO, 'Participant Categories in the National Electricity Market' (Australian Energy Market Operator), 2.
[2] See for example rule 2.2.1 of the *National Electricity Rules*.

Consequently, this further entrenches the generation ownership in a limited number of participants, thus reducing competition overall.

8. The Program seeks to address those issues by underwriting new generation projects that fall within certain criteria. The precise mechanism for delivery is yet to be determined, but a number of funding means have been suggested including floor prices, contracts for difference, cap and floor (collar) contracts, loans and capacity payments.

9. The Australia Institute is concerned about the legal authority of the Program (and in particular, the capacity of the Commonwealth to expend monies in support of it). In particular, we have been asked to advise on the following:
    a. What are the restrictions on Commonwealth spending, that may curtail part or all approaches within the Program; and
    b. Under what authority and/or conditions, could the Commonwealth pursue the Program, without the need for new legislation (including derivative contracts, loans, capacity payments)? How could this be challenged?

Restrictions on Commonwealth spending

10. In general, the Commonwealth's executive power to contract and spend public money is, in most cases,[3] limited to that for which it has positive authority.[4] That is, Commonwealth spending must ordinarily be authorised by legislation, and so supported by a source of federal legislative power. The High Court has made it clear that the mere earmarking of expenditure by way of an appropriation Act will not suffice for this purpose.[5]

11. Thus, according to the High Court in *Williams [No 1]*, the Commonwealth has the authority to expend money that has been legally appropriated when the expenditure is:

    a. authorised by the Constitution;

    b. made in the execution or maintenance of a statute or expressly authorised by a statute;

    c. supported by a common law prerogative power;

    d. made in the ordinary administration of the functions of government; or

    e. (possibly) supported by the nationhood power.

[3] Exceptions arise if the expenditure can be supported by some other recognized aspect of executive power – for example, the 'nationhood power' (see *Pape* (2009) 238 CLR 1 (***Pape***), the power to spend moneys in the ordinary annual services of government (see *New South Wales v Bardolph* (1934) 52 CLR 455), or under prerogative powers inherited from the common law powers of the Crown (see *Williams v Commonwealth [No 1]* (2012) 248 CLR 156 (***Williams [No 1]***).

[4] *Williams [No 1]*, 187[27], 192-3[36]-[37], 216-17[83] (French CJ), 236-9[150]-[159] (Gummow and Bell JJ), 353 [524] (Crennan J).

[5] *Pape*, 55[111] (French CJ), 73-74 [178]-[183] (Gummow, Crennan and Bell JJ), 113[320] (Hayne and Keifel JJ), 210-11 [601]-[602] (Heydon J).

12. If the expenditure of public monies falls outside of these categories, there is a reasonable prospect that the High Court would hold that such expenditure is invalid. Similarly, absent express legislative authority, the Commonwealth does not have the power to make 'major' or 'substantial' contracts. This would likely include the ability to enter into contracts for floor prices, contracts for differences, cap and floor (collar) contracts, loans and/or capacity payment contracts as contemplated by the Program. In general, unless a contract is for the administration of a department of state, the relevant cases suggest that legislative authority or approval is required. [6]

13. From a practical perspective, what this means is that for spending of consolidated revenue to be valid (including the ability to enter into contracts to carry out that spending), the Commonwealth is ordinarily required to enact specific legislation (or alternatively, fit an expenditure within existing legislation – discussed further below), such legislation having been made pursuant to one of its heads of powers set out in section 51 of the Constitution.[7]

14. In this scenario, the Commonwealth has no express power to legislate with respect to electricity generation *per se* (unlike, for example, its powers with respect to telecommunications or railways). However, the ability to legislate for (and thus fund or contract), the Program is most likely to be supported by the Corporations power set out in section 51(xx) of the Constitution (**Corporations Power**).

15. The Corporations Power gives the Commonwealth a (relatively) unrestricted ability to regulate economic activity, and in particular allows the Commonwealth to regulate the conduct of corporations. Without knowing the precise mechanism by which the Program is to be delivered, it is difficult to say whether it does in fact fall within this provision.

16. Nonetheless, given the broad nature of the power, it seems likely that the Commonwealth could ultimately fund the Program via legislation enacted under this power.

17. Another potential source of power may be section 51(xxix) of the Constitution, i.e. the external affairs power. This may power may be triggered if, for example, the relevant legislation included mechanisms designed to give effect to Australia's obligations under the UN Framework Convention on Climate Change (and Protocol), (such as by investing in the development of renewable energy or low emission technologies).

18. Other options available to the Commonwealth include funding the Program via grants to the States which participate in the NEM (via section 96 of the Constitution). Section 96 of the Constitution gives the Commonwealth the power to 'grant financial assistance to any State on such terms and conditions as the Parliament thinks fit'. A series of High Court decisions have clarified the meaning of the provision giving it a very wide construction, in which few (if any) restrictions can be applied.[8] Relevantly, the Commonwealth may attach almost any

[6] See for example *Australian Woolen Mills Pty Ltd v Commonwealth* (1954) 92 CLR 424; *Port of Portland Pty Ltd v Victoria* (2010)242 CLR 348.

[7] For example, legislation which permits the Commonwealth to fund an overseas aid programme may be supported by the external affairs power in section 51(xxix) of the Constitution.

[8] *Victoria v Commonwealth* (1057) 99 CLR 575; *Deputy Federal Commissioner of Taxation v Moran* (1939) 61 CLR 735 and *South Australia v Commonwealth* (1942) 65 CLR 373.

conditions it wishes to section 96 grants (including those within an area of non-federal jurisdiction).[9]

19. Section 96 of the Constitution confers a legislative power on the Commonwealth – that is, before any grant can be made to a state, appropriate legislation[10] must firstly exist. Whilst the exercise of the power is not conditioned upon the agreement of the states, it is typically connected with anterior intergovernmental agreements.[11]

20. If the Program were funded by way of section 96 grants, the Commonwealth could (in theory) impose virtually any condition it saw fit – including the desired method of executing the Program (i.e. providing for contracts for floor prices, contracts for differences, cap and floor (collar) contracts, loans and/or capacity payment contracts). Obviously, the States themselves would also need to have appropriate power to enter into the relevant end arrangements with the developers of any new generation assets.

Can the Commonwealth fund the Program via any existing legislation?

21. Given the (current) absence of specific legislation underpinning the Program, unless the Commonwealth can fit the terms of the Program into some pre-existing legislation, the Commonwealth is not (presently) validly able to fund it.

22. We have considered whether certain existing legislation could be used a potential source of funding the Program. In particular, we have considered whether there is potential for (at least) part of the Program to be funded by way of the *Clean Energy Finance Corporation Act* 2012 (**CEFC Act**).

23. Relevantly, the Clean Energy Finance Corporation (**CEF Corporation**) can invest funds in 'clean energy technologies'.[12] 'Clean energy technologies' are defined in section 60 of the CEFC Act and include energy efficiency technologies (i.e. those related to energy conservation or demand management technologies); renewable energy technologies (i.e. things like solar, wind, or hydro powers); or low-emission technologies (i.e. those which reduce the level of greenhouse gas emissions that ordinarily result from the production of power).

24. Other restrictions are imposed by virtue of various sections of the CEFC Act: the CEF Corporation cannot, for example:

[9] *A-G (Vic) ex rel Black v Commonwealth* (1981) 146 CLR 559. This was also the ultimate outcome in the *Williams* cases – once the High Court had determined the chaplaincy program was not within the Commonwealth's power to implement, the program was ultimately funded by section 96 grants to the States (and included the controversial restriction on the availability of funding to religious based chaplaincy programs only).

[10] Which specifies the relevant grant and any conditions to be satisfied or met before the funding will be provided.

[11] This is not, however, a pre-requisite for the exercise of the power. Provided that the legislation preserves the States' ability to accept or reject the grant (and any conditions), it is not necessary for an agreement to firstly be reached between the Commonwealth and the States.

[12] Section 58 of CEFC Act.

a. invest in technologies that are not solely, or mainly, Australian based (section 58, 61);[13]

b. invest in non-financial assets (i.e. real property). It is only able to invest in 'financial assets' (i.e. cash and deposits, loans) (sections 4, 63(2));

c. invest in technology for carbon capture and storage, or nuclear power or technology (section 62);

d. provide guarantees, except for repayments of a loan and even then, only if the loan is a complying investment (section 69); and

e. acquire derivatives for speculation or leverage (section 70).

25. The structure of the CEFC Act is that investment can only occur once specified 'triggers' are met - in short, they require individual assessment of any proposed new generation project. Whether a new generation project would fall within the ambit of that funding is therefore highly dependent upon the nature of the end project itself.

26. There is certainly potential for some new generation projects to be funded (in part) by the CEF Corporation. For example, a solar power generator may qualify. However, the CEF Corporation would not be able to enter into contracts which contained floor prices, contracts for differences, cap and floor (collar) contracts, or even contacts for capacity payments. These types of funding arrangements appear to contravene the requirements of section 70 of the CEFC Act. At most, it appears that the CEF Corporation may be able to invest in new generation technologies (assuming they meet the other requirements) by way of loans.

27. Thus, it is unlikely that the Program could be funded via the CEFC Act, unless that act were substantially amended. At best, the current position is that some projects may qualify for investment under the CEFC Act, however, this type of investment is unlikely to achieve the desired outcome of the Program (i.e. reduce the barriers to entry by providing some level of certainty concerning the potential price volatility of the NEM).

28. Similarly, we have considered whether there is an ability to fund the Program under the provisions of the *Public Governance, Performance and Accountability Act* 2013 (**PGPA Act**). The PGPA Act does not presently authorise payment for the types of contracts proposed in the Program – rather its focus is more upon ensuring appropriate policies, procedures and accountability mechanisms are in place for the financial management of government, rather than expressly legislating certain expenditures.

[13] The relevant guidelines note that the CEFC Board will have consideration to a number of factors in determining this issue, including things like: where the project is based, who it will be used by, where are the project's management and/or operational activities primary locations, where the expenditure for the project will be primarily incurred, the nexus between the recipient and Australia (including the location of its assets, employees, costs and/or revenues)

29. Further, and unlike the *Financial Management and Accountability Act* 1997 (the predecessor to the PGPA Act), the PGPA Act does not appear to include any ability to authorise expenditure that is not otherwise within the Commonwealth's power.[14]

30. In *Williams [No 2]*, the Commonwealth inserted section 32B in the *Financial Management and Accountability Act* 1997 (the predecessor to the PGPA Act) to address the issues raised in the High Court's decision in *Williams [No 1]*.[15] That section purported to validate executive spending on a number of programs, grants and arrangements (including the contested chaplaincy scheme), and also purported to allow the executive to enter into and engage in spending on future programs or grants (without further parliamentary scrutiny) provided it fit within one of the existing descriptions set out in the regulations. The regulations identified over 400 programs and grants, many of which were described broadly. There was also an ability for the regulations to be amended.

31. The validity of that section was challenged in *Williams [No 2*]. Despite that provision, the High Court again found that the funding of the chaplaincy program was not constitutionally valid – in particular, it held that the program's inclusion in the regulations was not validly supported by section 32B, because the "benefits to students" aspect of section 51(xxiiiA) of the Constitution had not been properly engaged. Thus, absent a proper connection to that power, the inclusion of the program in the regulations was invalid.

32. As noted above, the effect of the various High Court decisions is that absent any connection to the exercise of a Constitutional power (i.e. in the form of validly enacted legislation) expenditure is usually not valid.

33. Our consideration of pre-existing legislation has not been exhaustive. It is possible that there are other sources of pre-approved funding that may be available to the Commonwealth, however, we are not presently aware of those sources.

Ability to challenge the Program

34. Whether the Program can be challenged ultimately depends upon its method of execution. If, for example, the Commonwealth were to simply commence payments under the Program, without firstly enacting supporting legislation, it is highly susceptible to challenge. The position may be less certain if the Commonwealth were first to enact supporting legislation. The ability to challenge that legislation would ultimately depend upon its drafting.

35. Ordinarily, however, expenditure of the Commonwealth that is outside power is challenged in the High Court. The question then becomes – who has standing to commence such a challenge?

36. The question of standing is complex. In summary, it is often (but not invariably) determined by questioning whether the applicant has a special interest in the subject matter of the action

[14] See for example sections 51 and 52 of the PGPA Act.

[15] In *Williams [No 1]* the High Court concluded that the chaplaincy payments fell outside any particular constitutional power, and was therefore invalid.

over and above that enjoyed by the public generally.[16] This usually requires (as a prerequisite to any declaration or injunction being obtained) some injury to an individual interest, and a special interest in the subject matter of the action as distinct from the interest of the public generally.

37. Often, these types of cases are instituted by the States, public interest groups (such as environment groups), or individuals who have been impacted by the matter in question (e.g. in the *Williams* cases, Mr Williams was found to have standing by virtue of his children attending a particular school).

38. Here there are a range of persons who might have sufficient standing to challenge the funding of the Program – certainly a proposed developer of new generation assets would seem capable, as might an environmental interest group. However, again, the question of who may be an appropriate applicant will ultimately depend upon how the Program is to be implemented.

Conclusion

39. At present (and without the benefit of a more detailed scheme proposal), it does not appear that the Commonwealth has the ability to fund the Program. Rather, the Commonwealth will need to enact some form of supporting legislation, or alternatively, amend existing legislation, in order to operate and fund the Program.

40. In order to do so, the Commonwealth will need to ensure that such legislation (or amending legislation) falls within one of its constitutional powers. The most likely source of power is section 51(xx) of the Constitution (i.e. the Corporations power), although other sources of power may be available.

41. Our advice is obviously limited by the fact that the method of implementing the Program has yet to be determined by the Commonwealth. Once such a decision is made, we are content to revisit this advice and provide more firm views upon the validity (or otherwise) of any proposed scheme or expenditure.

Dated: 15 February 2019

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[16] *Boyce v Paddington Borough Council* [1903] 1 Ch 109; *Australian Conservation Foundation v Commonwealth* (1980) 146 CLR 493; *Onus v Alcoa Australia Ltd* (1981) 149 CLR 27.