

Competition Law News

Competition Tribunal authorises AGL to acquire Macquarie Generation in ground breaking decision

WHAT YOU NEED TO KNOW

- Australian Competition Tribunal (**Tribunal**) has today granted AGL Energy Limited (**AGL**) authorisation to acquire Macquarie Generation, stating in its summary judgment: *"Indeed, the Tribunal is satisfied that the risk [to NSW retail competition] identified by the ACCC is unlikely to occur."*
- On 4 March 2014, the ACCC announced that it would oppose AGL's proposed acquisition due to competition concerns. On 27 March 2014, AGL took the unprecedented route to securing competition clearance by applying to the Tribunal for merger authorisation. This is the first time that the Tribunal has determined an application for merger authorisation since the current regime was introduced in 2007 by the then Treasurer Peter Costello in response to recommendations made by the Dawson Review.
- The Tribunal applies a net public benefit test. It found that the proposed acquisition: *"is likely to result in substantial public benefits and that the public detriments identified by the ACCC are unlikely to occur"*.
- The decision demonstrates that merger authorisation by the Tribunal can be a viable alternative to seeking informal merger clearance from the ACCC, and a viable response to a decision by the ACCC to oppose a transaction.

Ashurst acted for AGL in these proceedings.

AGL's application

In November 2013 AGL Energy Limited (**AGL**) applied to the ACCC for informal merger clearance to acquire the key assets of Macquarie Generation, which include the Bayswater and Liddell coal fired power stations in NSW. The NSW government offered those assets for sale as part of its ongoing electricity asset privatisation process.

On 4 March 2014 the ACCC announced that it would oppose AGL's proposed acquisition on the basis that it would be "likely to result in a substantial lessening of competition in the market for the retail supply of electricity" in NSW. The ACCC formed the view that the proposed acquisition would be likely to result in a significant reduction both in hedge market liquidity and the supply of competitively priced and appropriately customised hedge contracts to second tier retailers competing in NSW.¹ The ACCC also

stated that it "remained concerned" about the likely competitive impact of the proposed acquisition on wholesale electricity markets in NSW, Victoria and South Australia.

On 27 March 2014 AGL took the unprecedented route to securing competition clearance by applying to the Australian Competition Tribunal (**Tribunal**) for merger authorisation. AGL's application was supported by 16 sworn statements from 9 lay witnesses, and reports and statements from 6 expert witnesses. The ACCC provided a report to the Tribunal, as well as evidence from 9 lay and 5 expert witnesses. A two week hearing was held from 2 to 13 June 2014.

Today, the Tribunal handed down its decision granting that authorisation.

What is merger authorisation?

Section 50 of the *Competition and Consumer Act 2010* (**CCA**) prohibits acquisitions that would have the effect or likely effect of substantially lessening competition in a market. Merger parties typically seek informal

¹ "Hedge contracts" are financial instruments acquired by electricity retailers from generators or other market participants to manage the financial risks associated with acquiring wholesale electricity, including the risk of significant fluctuations in the wholesale electricity spot price.

clearance from the ACCC for mergers which may potentially raise concerns under s50.

However, the CCA also provides for merger authorisation by the Tribunal. If granted, this alternative avenue protects a merger or acquisition from challenge under s 50.

Section 95AT(1) of the provides that the Tribunal "must not grant an authorisation in relation to a proposed acquisition... unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to occur".²

The Tribunal comprises a Federal Court judge, and two other members with relevant experience (eg in economics, business or regulation). The Tribunal's decision is subject to a statutory 3 month time period.³

Tribunal findings on competition issues

The key anti-competitive detriments (or theories of harm) proposed by the ACCC were:

1. that AGL as a vertically integrated operator will not have the incentive to offer NSW hedge contracts to smaller electricity retailers to residential consumers in NSW; and
2. that AGL will have the inducement to, and capacity to, directly influence the wholesale market for electricity in the NEM.

In its summary judgment, in relation to the retail market concerns, the Tribunal found that the proposed acquisition "is not likely to result in a significant detriment to the ability of retailers, including small retailers, to compete in the retail market for the supply of electricity in NSW... Indeed, the Tribunal is satisfied that the risk identified by the ACCC is unlikely to occur".⁴

The Tribunal made a number of factual findings supporting that assessment, including that:

- at present (that is pre-acquisition) the "market" for hedge contracts available to retailers in NSW is not a tight one and is not therefore constrained;⁵

- the probable cause of the relatively lower participation of smaller retailers in NSW is, in part, the consequence of retail price regulation, and is not caused by a tight market for hedges in NSW;⁶
- post the Proposed Acquisition, retailers of electricity in NSW, including small retailers, will still have available a significant competitive "market" in NSW for the acquisition of hedge contracts.⁷

The Tribunal was satisfied that none of the range of "without" cases (ie the hypothetical future in which the proposed conduct was not authorised) it considered would cause small retailers to be significantly assisted or impeded in competing in the NSW retail electricity market, compared to the future with the proposed acquisition. It stated that the structural change resulting from the proposed acquisition "will not result in material detriment to the public by reason of a lessening of competition in the retail market for the supply of electricity in NSW".

Indeed, the Tribunal was satisfied that " after the Proposed Acquisition there will be active competition in the NSW retail market, including by small retailers that will have a substantial and adequate hedge market available to them".⁸

In relation to the wholesale market concerns, the Tribunal was satisfied that there is "no real risk" of AGL being able to engage in such conduct: the Tribunal stated that it "does not find that the Proposed Acquisition will put AGL in a position to exert significant market power in the NEM (or in NSW as a region of the NEM) to spike the spot price or to cause volatility in the wholesale market".⁹

Finally, while the Tribunal accepted AGL's proffered conditions to make a certain volume of NSW hedge contracts available to independent retailers, it stated that "the availability of the conditions has not been critical to the Tribunal's view".¹⁰

The ACCC unsuccessfully ran similar theories of harm in 2003 in opposing AGL's acquisition of a partial interest in the **Loy Yang Power Station**. In rejecting those concerns, French J (as he then was) held that:

- it cannot be said that it is likely that AGL's acquisition of the interest in Loy Yang will lead to a thinning of the hedge contract market, such that the flow-on effects into the retail market

² In contrast, the ACCC's informal merger clearance process focuses solely on whether the merger would or would be likely to substantially lessen competition.

³ The Tribunal can extend the period by up to a further 3 months in certain circumstances, but did not do so in these proceedings.

⁴ Application for Authorisation of Acquisition of Macquarie Generation by AGL Energy Limited [2014] ACompT 1 (**Decision**), [23].

⁵ Decision, [26]. In this context, the Tribunal did not use the term "market" in a technical sense, as neither AGL nor the ACCC suggested

that there is a need to consider a separate market for hedge contracts: [28].

⁶ Decision, [26].

⁷ Decision, [27].

⁸ Decision, [39].

⁹ Decision, [34].

¹⁰ Decision, [31].

propounded by the ACCC could not be accepted;¹¹ and

- opportunistic bidding during periods of high demand to increase the spot price does not reflect a longrun phenomenon having regard to the possibilities of new entry through additional generation capacity and the upgrade of interconnections between regions, and does not amount to an ongoing ability to price without constraint from competition.¹²

Tribunal findings on public benefits

The Tribunal found that there are significant benefits to the public that are likely to follow from the proposed acquisition. In particular:¹³

- The benefits to the State and to the public of NSW of being able to dispose of the Macquarie Assets at a price which reflects their retention value, providing the State immediately with about \$1 billion, and in circumstances where the State has determined, on the basis of a series of reports extending back to the Owen Inquiry in 2007, that it is in the interests of NSW to do so. Those funds would be applied to funding of infrastructure improvements for NSW. The State would also be relieved of operating the assets, which have a limited life and an increasing level of inefficiency and vulnerability to break down.
- The investment by AGL of \$345 million in the efficient operation of the Macquarie Generation assets, so as to increase their capacity and longevity, and in turn to generate more and cheaper electricity to the wholesale market.

While the Tribunal considered AGL's further public benefit claims arising from AGL being able to operate the Macquarie Generation assets more efficiently and to invest significantly in their upgrading, it stated that it did not need to decide on them (except in relation to its consideration of the amount another bidder may be prepared to pay for the assets).¹⁴

What's next?

The ACCC can seek review of the Tribunal's decision in the Full Federal Court. The last date for lodging an appeal is 22 July 2014.

In general terms, the grounds of review are as follows: error of law (ie that the Tribunal applied the wrong test); failing to take account of relevant considerations and/or taking into account irrelevant considerations; denial of procedural fairness; and

making a decision that is so unreasonable that no reasonable decision maker could have made it.

Significance of the decision

The Tribunal's decision is a ground breaking development for the Australian electricity industry, and for merger clearance processes in Australia.

The Tribunal's decision has significant consequences for merger parties' strategic decisions about how to secure competition clearance for a proposed acquisition. It demonstrates that merger authorisation by the Tribunal can be a viable alternative to seeking informal merger clearance from the ACCC, and a viable response to a decision by the ACCC to oppose a transaction.

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¹¹ *AGL v ACCC* (2003) 137 FCR 317 at [564] and [598]. See also [599].

¹² *AGL v ACCC* (2003) 137 FCR 317 at [493].

¹³ Decision, [35] and [37]

¹⁴ Decision, [38].

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