The Australian Competition Tribunal grants first
direct merger authorisation (Macquarie
Generation, AGL Energy)

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On 25 June 2014 the Australian Competition Tribunal (Tribunal) handed down its first direct
authorisation decision, approving the AU$1.505 billion acquisition by AGL Energy Limited of the
assets of Macquarie Generation (MacGen), a state-owned corporation (AGL-MacGen). The
authorisation decision followed advice from the Australian Competition and Consumer Commission (ACCC) that it would oppose the proposed deal. The Tribunal disagreed with the ACCC’s assessment
of the likely anti-competitive impact of the merger and also considered that there were public
benefits associated with the proposal that justified allowing it to proceed. On 3 Sept 2014 AGL
announced it completed the $1,505 million acquisition of MacGen assets from the NSW Government.

Australia’s merger law and the role of the ACCC

Section 50 of the Competition and Consumer Act 2010 (the CCA) prohibits acquisitions of shares or
assets where the acquisition would have the effect, or be likely to have the effect, of substantially
lessening competition in any market.

There is no obligation for parties to notify the ACCC prior to completion of a deal. In practice,
however, parties frequently voluntarily notify the ACCC ahead of closing to obtain an ‘informal’
assessment of their proposed acquisition. In many cases, including AGL’s proposed acquisition of
MacGen, the parties make ACCC approval of the transaction a condition for completion.

Following informal review the ACCC may oppose, approve or conditionally approve a merger. As
informal merger review is a purely administrative process, opposition by the ACCC does not impose
any legislative impediment against proceeding with the proposed acquisition, but as a practical
matter any attempt to do so is likely to be met with injunctive proceedings by the ACCC, or an
application for divestiture or penalties once the acquisition has occurred.

Merging parties also have the opportunity to seek a ‘formal’ merger review, which is underpinned by
legislation. To date no party has utilised this process which is generally thought to be unattractive compared with the informal process as a result of the complexity of the notification form, the greater public disclosure requirements and the threshold requirement that the ACCC be satisfied the acquisition would not have the effect or likely effect of substantially lessening competition before clearance can be granted [1].

Public benefit authorisation

In addition to the merger review process, which assesses only the likely competitive impacts of a proposed merger or acquisition, the CCA allows parties to seek advance approval for their acquisition (s 95AT) where they consider that there exists a public benefit likely to outweigh any potential anti-competitive detriment (s 95AZH). If granted, s 50 will not apply to prevent the acquisition.

Until 2007 merger authorisation applications were heard by the ACCC, with the opportunity for a merits appeal to the Tribunal. In 2007 this power was removed from the ACCC with the result that parties wishing to apply for merger authorisation now proceed directly to the Tribunal, which has three months to make a determination (s 95AZI). The ACCC does, however, retain a significant role in the authorisation process. In particular, the Tribunal must require the ACCC to provide it with a report in relation to the application (s 95AZEA) and the ACCC has the right under s 95AZF to call a witness, report on statements of fact put to the Tribunal, cross examine any witness appearing in relation to the application and may make submission on any relevant issue. The Tribunal may also require the ACCC to provide information or any other assistance in relation to the proceedings. In relation to the AGL-MacGen application the ACCC provided the Tribunal with a 150 page report and a variety of other evidence.

The market

Australia has established a National Electricity Market (NEM) [2], operated by the Australian Energy Market Operator (AEMO) in accordance with National Electricity Law and National Electricity Rules (the Rules) [3]. The NEM is a wholesale spot market through which output from generators is aggregated and power supply and demand is matched through a centrally coordinated process. Generators offer to supply at specified prices for set time periods and, based on this, the AEMO decides which generators will produce electricity, with the lowest price generator dispatched first. The dispatch price is determined every five minutes and dispatch prices are averaged every six minutes to determine a ‘spot price’ for each region. The Rules set a Market Price Cap representing the maximum spot price and also set a minimum spot price.

Retailers pay the AEMO the spot price calculated for their region. To protect against spot price volatility, retailers purchasing from the NEM use financial contracts, such as hedge contracts, to lock in a price for electricity to be consumed at some time in the future [4].

At the time of the application AGL held significant retail and wholesale electricity interests, including generation assets in Victoria and South Australia. It did not have any generation assets in New South Wales (NSW), Australia’s most populous state, but held approximately 16 per cent of the retail electricity load in the state [5].

MacGen was wholly owned by the State of NSW. The assets sought to be acquired included two
black coal generation plants representing the second and fourth largest power stations in Australia and accounting for 27 per cent of NSW’s electricity generation capacity [6].

The retail market for electricity supply in NSW is dominated by AGL, Origin Energy Ltd and EnergyAustralia Holdings Ltd. Both Origin and EnergyAustralia are vertically integrated retailers, known as gentailers.

The NEM is currently oversupplied with electricity and this oversupply is expected to continue for some time [7].

**ACCC assessment**

AGL applied to the ACCC for informal clearance on 2 December 2013. Following market inquiries, on 6 February 2014 the ACCC issued a Statement of Issues, outlining preliminary competition concerns and inviting further public comment. The ACCC was primarily concerned the acquisition would increase barriers to entry and expansion in the retail supply of electricity in NSW. In particular, it considered there would be a reduced ‘liquidity in the supply of hedge contracts due to the reduced volume of hedge contract trading as AGL’s retail load will be supported with a natural hedge’ which may ‘increase the risk of spot price exposure for independent retailers’ [8]. In addition, following the acquisition there would be three major ‘gentailers’ holding approximately 70% of generation capacity, 80% of generation output in NSW and more than 85% of retail electricity load, making it difficult for independents and new entrant retailers to gain the hedge contracts needed to effectively compete. The acquisition would also remove the largest source of independent generation capacity in the NEM [9].

In an effort to address the ACCC’s concerns about the availability of hedge contracts, AGL proffered a draft Undertaking [10] to the ACCC which, if accepted, would require AGL to make available a certain volume of competitively priced hedge products to the competitors for several years. The ACCC did not accept that this undertaking was capable of addressing their concerns and, on 4 March, announced it would oppose the proposed acquisition [11].

**The Tribunal’s assessment**

On 24 March 2014 AGL applied to the Tribunal for authorisation of the proposed acquisition. When considering whether or not to grant authorisation, the Tribunal compares the level of public benefit ‘with’ the proposed merger against the likely level ‘without’ the proposed merger. Although the future was speculative, the Tribunal considered that without the proposed acquisition it was likely the State would retain and operate the assets in the short to medium term. It would endeavour to sell the assets in the medium to longer term, but the price obtained was likely to be significantly less than that offered by AGL [12].

AGL argued both that the merger would not substantially lessen competition ‘in relation to the generation and wholesale supply of electricity in the NEM, or the retail supply of electricity in NSW’ [13] and that it would produce three key public benefits:

- benefits to the state in disposing of assets reflecting their retention value, which would result in approximately $1 billion of the proceeds of sale being paid into a Restart NSW Fund to be utilised to fund major infrastructure projects;
increased availability and efficiency of the acquired power plants, including through investment of approximately $345 million over the life of the assets [14]; and

- efficiencies generated through vertical integration which would result in lower electricity prices for end consumers [15]. The Tribunal accepted that the proposed acquisition:

- would result in significant public benefits; and

- was unlikely to result in any material detriment to the public. As a result, it was satisfied that authorisation should be granted [16]. In relation to public benefits, the Tribunal considered that the benefit to the public from the immediate sale of the asset and payment of $1 billion to the Restart NSW Fund was sufficient in itself to justify authorisation [17]. The Tribunal also considered that AGL’s proposed investment in the assets represented a significant public benefit by prolonging the life and approving the availability of base load generating capacity [18]. In relation to vertical integration, the Tribunal noted that the benefits accrue primarily to AGL and the public benefit was more inchoate [19], but nevertheless accepted there may be potential benefits to the public from the efficiencies of vertical integration [20]. The only public detriments suggested by the ACCC were adverse effects on competition. The Tribunal disagreed with the ACCC’s assessment, concluding that the market for hedge contracts to retailers in NSW was not constrained and that post-acquisition small retailers would still have available a significant competitive ‘market’ for hedge contracts in NSW [21]. As a result, it did not consider the acquisition would be ‘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’ [22]. In addition, the Tribunal considered that the post-acquisition rivalry of the three large gentailers would ‘produce a vigorous competitive market’ [23]. The Tribunal also rejected the ACCC’s claim that the acquisition would ‘entrench an uncompetitive oligopoly’ [24] and made clear that it is behaviour and not structure that should be the focus of a competition assessment: There is nothing inherently wrong with a market in which three large firms compete vigorously for market share where there are incentives to steal customers away from rivals. It is behaviour that matters, not structure per se. It appears to the Tribunal that it has been invited to assume that the “Big 3” will not constitute a competitive market principally on the basis of their combined market share immediately post-acquisition on an assumption that competition between them would become muted over time. In the opinion of the Tribunal, oligopolies should not be thus prejudged [25]. The Tribunal concluded that the proposed acquisition ‘will have no adverse impact upon competition in the wholesale market for electricity in the NEM, and little or no adverse effect on competition in the retail market for electricity in NSW [26].’ As a result, the Tribunal was satisfied that there were ‘no material detriments to the public interest which need to be balanced against the benefits to the public which the Tribunal has found will follow if the Macquarie Assets are permitted to be transferred to AGL’ [27] and granted authorisation.

**Behavioural remedies** The Tribunal may grant authorisation subject to conditions (s 95AZJ). AGL submitted that those conditions, which were consistent with those it had previously proposed to the ACCC, were unnecessary because the Tribunal could be satisfied of a net public benefit from the acquisition without them. Nevertheless, although the Tribunal did not consider the conditions critical to its view [28], it did accept the conditions which had been proffered by AGL as an ‘additional matter to reinforce the position of small retailers’ [29] and granted the authorisation subject to those conditions. The conditions require AGL to offer, or enter into a prescribed quantity of hedge contracts priced by reference to the NSW RRP, for a period of six and a half years.

**Implications of the decision** The ACCC has had limited success challenging mergers in recent years. There have been only two federal court decisions involving ACCC challenges to mergers under the current law, both of which the ACCC has lost [30]. Consistent with the
approach adopted by the courts in those cases, the Tribunal emphasised the need to look at commercial reality rather than theory alone when assessing competitive impact. In particular, it emphasised the importance of focussing on past and likely future behaviour of firms in the market rather than relying too heavily on structural considerations. In recent years the ACCC has been criticised for the time it has taken to review complex mergers [31]. The success of the AGL-MacGen authorisation suggests that authorisation is now a viable alternative to the ACCC review process for complex mergers that may present some competition concerns, but which offer the potential for public benefits.


[2] The NEM connects the Australian states of Queensland, New South Wales, Victoria, South Australia and Tasmania, but not West Australia or the Northern Territory


[10] The ACCC may accept enforceable undertaking from parties designed to alleviate competition concerns (effectively a merger remedy): section 87B CCA.


[14] AGL authorisation application, para 21.1


[20] AGL-MacGen para 260. See also para 262.

[21] AGL-MacGen para 260. See also para 262.


[23] L-MacGen para 30. See also para 343.


[27] AGL-MacGen para 375.


[29] AGL-MacGen para 376.
