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**SUBMISSION TO THE EXECUTIVE DIRECTOR
ENERGY AND SECURITY DIVISION
DEPARTMENT OF INFRASTRUCTURE
CROSS-OWNERSHIP RULES FOR THE ENERGY SECTOR**

1. Background on the CLCV

The Consumer Law Centre Victoria (CLCV) welcomes the opportunity to make this submission in response to the Issues Paper, Cross-ownership Rules for the Energy Sector.

The CLCV is one of Australia's leading consumer and public interest organisations. A not-for-profit, independent organisation, we undertake research, policy development, advocacy and education. The CLCV's work is focussed on advancing the interests of consumers, particularly low-income and vulnerable consumers. The CLCV is currently working on a range of issues, including utilities, competition and consumer protection policies, financial services, telecommunications, exploitative credit and access to justice. The CLCV also operates a large free consumer legal practice.

2. Summary of Issues Paper Questions

Directly and indirectly, the Issues Paper raises the following questions:

- can strict quantitative restrictions alone effectively manage competition issues arising from reintegration in the Australian energy sector?;
- is a State approach to merger restrictions in the Australian energy sector appropriate, or should it be a national approach?;
- are energy specific as opposed to general merger rules appropriate for regulating mergers in the Australian energy sector?;
- should energy sector merger decisions be made by government or an independent regulator?; and
- should energy sector merger decisions by a regulator be reviewable by a court?

3. Overview of CLCV Position

3.1 The CLCV welcomes the contribution of National Competition Policy to Australia's overall productivity and acknowledges its success in major consumer markets. In our view, fair, effective competitive markets deliver the best price, quality and access to goods and services for the majority of Australian consumers. Further, we support the role of government in setting a policy framework to ensure that a competitive energy sector is maintained. However, in our view, specific decisions regarding reintegration in the energy sector should be made by an independent regulator.

3.2 We consider that the current Victorian cross-ownership rules are inappropriate and should ultimately be repealed for three reasons:

- the ease with which they can and will be amended in individual cases makes them redundant;
- they have limited impact in that they only affect mergers between Victorian licensed operators and have no impact on 'mergers between Victorian and non-Victorian energy sector businesses [which] may cause the market to become more concentrated at a local or regional level'¹; and
- they do not allow a qualitative assessment and preclude an appeal of what would be a negative merger decision. In our view, quantitative restrictions should guide an ultimately qualitative regulatory decision. Such an approach will enable mergers to be blocked where there is a substantial lessening of competition and will minimise errors that result from blocking a merger that could potentially benefit the overall community had it been allowed to proceed.

3.3 We also believe that energy specific merger rules are appropriate because:

- they can minimise the risk of errors that result from not blocking a merger that could lead to consumer detriment as a result of price increases or service reductions; and
- the Trade Practices Act's (TPA) focus on market share is inappropriate in the energy industry because measures of market share will not indicate what will happen to prices if, for example, generation output is reduced.

4. Summary of recommendations

4.1 The Governments that form the Ministerial Council on Energy (MCE) should develop national quantitative ownership restrictions to apply to mergers in particular regions of the national energy markets, and once developed, the national quantitative restrictions, as they apply to Victoria or regions making up Victoria, should replace the Victorian cross-ownership rules;

4.2 The national quantitative ownership restrictions should not be able to be amended to suit an individual merger case, but should be reviewed and amended periodically as the competitiveness and ownership concentration of the energy markets within regions changes;

¹ *Proposed Changes to Merger Control and Cross-Ownership Rules: Implications for Consumers*; JayCee Asia Pacific Consulting Pty Ltd, 14 April 2005.

- 4.3 The national quantitative ownership restrictions should guide merger decisions of a national independent regulator, preferably the ACCC, in conjunction with the existing section 50 test under the TPA; and
- 4.4 The regulatory decision should be reviewable by a court.

5. Answers to Issues Paper Questions

5.1 **Given the interrelationship of the Victorian cross-ownership provisions with the TPA, are there benefits from retaining the current Victorian cross-ownership provisions?**

Our concern with the current form of the Victorian cross-ownership rules arises from the ease with which they can be amended. The AGL acquisition of Loy Yang A demonstrates that the cross-ownership rules in Victoria can and have been modified in individual cases. In our view, it is this aspect of the Victorian cross-ownership rules that make the rules redundant.

We are, however, comfortable with the interrelationship between the Victorian cross-ownership rules and the TPA in the sense that the effect is that the rigid quantitative restrictions in the Victorian cross-ownership rules are overlooked in cases where the ACCC makes an assessment that no competition issue arises. We are more concerned that, under the current cross-ownership rules, if the ACCC takes action to prevent a merger and the merger would also breach the cross-ownership rules, the effect of the cross-ownership rules is to block the merger and preclude an appeal of the ACCC decision to a court.

In our view, while a Government should be able to make law to satisfy its policy objectives in this area, specific decisions to carry out or enforce those objectives should be made by an independent regulator carrying out a qualitative analysis of the individual case. This will minimise the errors that result from blocking a merger that might benefit the community. Further, although we recognise the risks of judicial errors in energy merger cases, our view is that these risks should be minimised through clear legislative requirements and not by preventing judicial review. We therefore support and encourage the Victorian Government to take leadership in developing a more suitable national framework to guide regulatory decisions in energy merger cases (see discussion below).

5.2 **Is it appropriate to place sole reliance upon the TPA provisions for regulating changes in ownership in the national electricity market? Are measures in addition to the TPA required to protect the pro-competitive structure of the energy sector?**

While the TPA may be able to assess some aspects of energy market reintegration appropriately, for example horizontal retail mergers, there are limitations with the TPA approach that could lead to significant errors in assessment of the impacts of vertical reintegration or generation-generation mergers. The TPA does not allow consideration of features unique to an industry. The unique features of the energy industry are well documented, including the complexities of the alignment of energy traded in the wholesale NEM pool and the forward 'contract' market. Under the TPA, the ACCC will conduct a more sophisticated analysis of competition issues only where the proposed merger breaches the so called 'safe harbours'. A merger will not breach the 'safe harbours' where the four largest competitors have a market share of less than 75 per cent and the merged entity a market share of less than 40 per cent. This market-based approach could have significant shortcomings in assessment

of energy market mergers where significant impacts, for example on price, may not be apparent when considering ownership concentration alone, particularly where the whole of the Australian market is the reference point. Therefore, in our view, energy specific ‘safe harbours’ are required to effectively assess the likely impact of a merger in the energy sector.

Having said this, we recognise that there are a number of risks involved in the strict application of quantitative restrictions:

- there is no scope to focus on the consumer interest. That is, where strict quantitative limits are applied, there is a risk that, by virtue of not allowing a degree of regulatory judgment in the specific case, a merger is blocked that could have benefited the overall community through efficiency of production, and overall economic development; and
- there is also the risk that new entrants will be discouraged from entering the market because of perceived difficulties of exit.

For these reasons, in our view, it is preferable that quantitative restrictions, or ‘safe harbours’, specifically applicable to the energy sector, are used to complement the TPA. That is, energy specific quantitative ownership restrictions should work in conjunction with the TPA.

There are a number of options regarding the detail of how these restrictions could operate, including the universality of their application, the legislative or regulatory instruments that should contain them and the extent to which they should influence the regulatory decision. We deal with these practical aspects to a limited extent only below.

5.3 Can a competitive generation sector be maintained in Victoria through the TPA as it stands, or does it require other forms of regulatory intervention?

See above.

5.4 Are quantitative ownership limits capable of being struck that could apply to all potential merger cases, and that remain relevant over time?

No. Quantitative limits are not capable of adequately applying to all merger cases, especially over a significant period of time. However, specific quantitative limits could be set for different sub-classes of possible mergers, and as applying to different energy market regions. Of course, any definitive limit needs to be reviewed periodically. As stated above, we have not addressed the mechanics of such an approach, at this stage.

5.5 Is it appropriate to apply State-based quantitative restrictions given the increasingly national character of energy markets?

The effectiveness of any State acting alone to prevent market concentration issues will be limited because of the inability to regulate cross-border mergers. We consider that a better way to deal with energy market concentration is to replace the Victorian cross-ownership rules with national ownership restrictions. Having said this, there is no doubt that the complexities, including the physical limitations of the Australian energy markets, can result in sub-markets operating from time-to-time. Therefore, in our view, while any national cross-ownership restrictions should be based on national

policy direction and a national regulatory or legislative framework, it may be appropriate that quantitative restrictions apply to particular regions.

5.6 Could the State's policy objectives be better met by a different Victoria-specific cross-ownership regime?

Perhaps, but in our view it is preferable that a national approach be adopted for reasons stated in section 5.5 above.

5.7 Should the ACCC release expanded merger guidelines that deal expressly with the energy sector?

Our view is that the MCE should develop national quantitative ownership restrictions. These could operate as merger guidelines, but it may be more appropriate to place the ownership restrictions in legislation, such as the TPA or the National Electricity Law. Legislative restrictions would give a more prescriptive framework for the merger decision by the independent regulator and/or court, to ensure that appropriate quantitative restrictions that are developed for various regions (including Victoria) are taken into account. We recognise that the political and constitutional implications of the particular approach will involve careful consideration and should be the subject of further detailed consultation.

Please contact Natasha Leigh on 9629 6300 should you have any questions about this submission.

Yours sincerely

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10 May 2005