Australian Gas Light Company v. ACCC & Ors.*

(Case of Acquisition in Electricity Sector, Australia)

Forum:

Federal Court of Australia[1]

Legislative Provisions referred:

Trade Practices Act, 1974 [2]

1. Section 50 of the Act, incorporates provisions pertaining to 'Mergers'.
2. Section 4E of the Act, incorporates definition of 'market' and 'relevant market'.
3. Section 4G of the Act, incorporates definition of what constitutes for 'lessening of competition'.

Parties to the Case:

Australian Gas Light Company (AGL) - *Petitioner*
Australian Competition & Consumer Commission (ACCC) - *Respondent No. 1*
Great Energy Alliance Corporation Pty Ltd. – *Respondent No. 2*
GEAC Operations Pty Ltd. - *Respondent No. 3*

Facts of the Case:

AGL, an electricity retailer based in Victoria, Australia, sought to acquire, as part of a consortium, the Loy Yang A Power Station Business (LYP), a Victorian electricity generation business. The acquisition would have given AGL a 35% share in LYP, the maximum permitted by the *Electricity Industry (Prohibited Interests) Regulations 2003*. AGL sought an informal clearance from the ACCC for the proposed acquisition. This was denied by the ACCC and the ACCC indicated that, should the acquisition proceed, the ACCC would 'seek appropriate remedies from the Federal Court, including divestment'. Following this opposition from the regulator, AGL instituted proceedings in the Federal Court seeking a declaration that the proposed acquisition would not infringe *Section 50* of the Act that prohibits mergers which substantially lessen competition. This represented the first instance in which a party had challenged, in the courts, an informal clearance ruling of the ACCC and the first case which considered the merger test guidelines brought out by the Australian government in the year 2003.

Issues raised and observation thereupon:

AGL was required to establish that the acquisition was not likely to cause a substantial lessening of competition under *Section 4G read with Section 50* of the Act in any relevant market and the Court's observation thereupon are as follows-

Jurisdiction of the Court:

The ACCC opposed the application for declaration filed by AGL. It first argued that there was no jurisdiction for the court to grant a declaration, because there was no *'matter'* before the court that could appropriately be the subject of a declaration. They further argued that even if such jurisdiction existed, the declaration should not be granted because the merger would *substantially lessen competition.*

The Court observed that it is well established that a declaration can be made to the effect that a

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* [2003] FCA 1525, decided on January 08, 2004. Available on: http://www.austlii.edu.au/au/cases/cth/federal_ct/2003/1525.html. Last visited on October 15, 2013.

[1] The instant case has been a proceeding instituted by the Petitioner seeking declaration that the proposed acquisition does not infringe merger provisions laid down under the Trade Practice Act, 1974.

[2] Hereinafter referred as 'the Act'

proposed course of conduct is not unlawful. The making of a declaration as to the lawfulness of future conduct has long been accepted as an exercise of judicial power. The fact that declaratory relief relates to future conduct does not place it outside the bounds of federal jurisdiction. If the claim for the declaration arises out of a contemporary controversy in which a party's freedom of action is challenged in some way, that controversy can constitute a *matter* for the purposes of the exercise of federal jurisdiction, whether or not there is a real controversy is a question of judgment and thus the Court held that it is not therefore deprived of jurisdiction for want of a `matter' in the instant case.

Market definition:
The ACCC and AGL agreed that there were separate retail markets for the supply of electricity to residential and small customers, and for the supply of electricity to industrial and commercial customers in Victoria. However, the parties differed on the appropriate wholesale market definition. AGL alleged that there was a single market for the supply of electricity and electricity derivative contracts in the National Electricity Market (NEM). The ACCC asserted that there was a separate market for the generation and supply of electricity to NEMCO, and a separate market for the supply of electricity derivative contracts, and that both of these markets were confined geographically to Victoria. The Court held that, a market may be defined functionally by reference to wholesale or retail activities or a combination of both. The concept of product encompasses goods and services and, having regard to the definition of 'market' under *Section 4E*[3], it includes the range of goods or services which are substitutable for or competitive with each other. Thus the Court held that there was one NEM-wide market for the supply of electricity and derivative contracts.

Market Power of Loy Yang Partners (LYP):
The ACCC asserted that LYP already possessed market power, and that following the acquisition LYP would have more incentive to exercise its market power to increase the price of electricity. ACCC relied for its assertion on the econometric evidence that purported to show the ability of LYP to increase the pool price and the market behaviour of the company during the summer of 2001, wherein it engaged in a bidding strategy that had the effect of increasing spot prices in the market at that time. However AGL pointed out that the fact that the high prices in 2001 had led to a spate of new generation within six months which caused the prices to drop again showed that the market was competitive and no generator had the ability to cause a sustainable increase in the price. The Court observed that LYP does not have market power in the sense of an ability to secure price increases free of competitive response. The ability to respond in times of high demand in a way has the effect of increasing the spot and forward prices is only transient and not sustainable and therefore the Court held that such ability does not equate to market power.

With reference to the point that such merger if allowed between LYP and AGL would 'likely' to have the effect of lessening of the competition (as under Section 4G of the Act), the Court propounded that the collocation 'likely to have the effect' is capable of bearing two meanings. One is that the proposed acquisition will 'more probably than not' have the requisite effect. The other is that there is a sufficiently high finite probability that the acquisition will have that

[3] Section 4E of the Trade Practices Act, 1974, 'for the purposes of this Act, unless the contrary intention appears, market means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.'

effect. The latter construction is sometimes expressed by saying that there is a 'real chance' of a substantial lessening of competition resulting from the acquisition. The meaning of 'likely' reflecting a 'real chance or possibility' does not encompass a mere possibility and therefore, in the instant case, the court observed that the assessment of the risk or real chance of a substantial lessening of competition cannot rest upon speculation or theory and thus not applicable in the instant case.

Vertical Integration:

ACCC in its findings had held that allowing the merger would have led to a vertical integration and thereby would have 'likely to lessen the competition'. The Court concluded, that because the electricity industry demonstrated a clear tendency toward vertical integration, and because vertical integration could be achieved through a variety of means, the instant merger could not be said to have the effect of substantially lessening the competition.

Therefore, after analysing each issue, the Federal Court of Australia issued the declaration that the merger would ***not substantially lessen the competition.*** *The declaration was subject to certain structural undertaking to be made by AGL to the Court.*

Analysis of the Order:

This case has been first in Australia wherein, a company informally restricted by ACCC from merging has approached Federal Court for the approval of the transaction and getting a declaration for its significance. This has been considered as the landmark decision in the Australian Competition regime as the case brought to the fore many ambiguous provisions laid down in *the Trade Practices Act, 1974*. Australia adopted *Competition and Consumer Act* in 2010. The new Act, by way of an amendment in 2011 introduced a concept of 'creeping acquisition'[4], a type of acquisition that may have restricted merger between LYP and AGL, however, this provision as wasn't clearly laid down in the previous Act, helped LYP and AGL to succeed in their said transaction. The new provision ensures that *Section 50* applies to acquisitions in the local markets and that the impact on competition can be considered in any market.

In the instant case the Court considered the possibility that there would be a risk that a court may in future adopt the view that the 'substantiality'[5] of a market should be determined by reference to Australia as a whole, making it difficult to argue that a local market would be found substantial. Therefore, in the light of such observations another amendment was made to address the potential uncertainty in defining what a 'market' is for the purpose of Section 50. Amendments were made to replace 'a market' with 'any market' under *Section 50 (1),* also definition of market as provided under *Section 4E* was broadened to include local markets so that creeping acquisition can also be scrutinised and lastly, the word 'substantial' was removed from Section 50 (6), so as to remove doubts regarding the ACCC's or a Court's ability to examine markets, including local markets, which may be relatively geographically small, where creeping acquisition concerns may arise in the future.

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[4] Creeping acquisitions are a series of small-scale acquisitions that individually do not substantially lessen competition in a market, although collectively may have the potential to do so over time.

[5] As mentioned under Section 50 of the Trade Practices Act, 1974.