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NCP Inquiry  
Productivity Commission  
PO Box 80  
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Dear Sirs

### **Review of National Competition Policy Arrangements**

AGL makes this supplementary submission in response to comments made in the submission of the Australian Competition and Consumer Commission dated 13 July 2004. In that submission the ACCC expresses concerns arising out of the Federal Court's recent decision in relation to the acquisition by AGL of a 35% equity interest in Loy Yang A power station.

Having considered the historical, theoretical and comparative context, AGL submits that:

1. The competitive effects of vertical integration are specific to the facts of any particular case, and vertical integration is, of itself, neither pro nor anti-competitive.

There are various theories of the competitive effects of vertical integration, some pro-competitive and some anti-competitive. Numerous studies of vertical integration are reported in both the economic and legal literature; various empirical studies have analysed the impact of vertical integration across international electricity industries. Among these studies are cases where vertical integration raises competition concerns and others where vertical integration achieves greater efficiency.

Competing conceptions of the incentives for, and forms and competitive effects of, vertical integration mitigate against generalisations as to whether it is a positive or negative development.

2. There is no historical concern in Australian competition law thinking arising from integration between the generation and retail sectors in the electricity industry.

In the industry restructuring to create the National Electricity Market the focus of reform was on the regulation of network monopoly infrastructure. Separation (structural and/or operational) of monopoly functions, in particular the transmission networks, from potentially competitive functions was pursued; the potential integration of the generation and retail functions provoked no concern.

3. International comparison reveals little concern for vertical integration between the generation and retail levels, and reinforces the reasoning of the Federal Court in the 'Loy Yang case' in several respects.



Examination of experience in Britain, Europe and North America substantiates the view that vertical integration between competitive sectors of the electricity industry raises no competition concerns in principle. Structural trends in Britain and Europe suggest an incipient return to at least limited re-aggregation of the industry. Vertical integration in Britain has been assessed as not likely to render the electricity derivatives market less liquid, a conclusion reflected in Justice French's decision in the Loy Yang case.

4. The Merger Guidelines' horizontal merger safe harbour thresholds are an important feature of a stable investment environment and should not be modified unless the arguments for and against have been quantified and tested, and a clear net benefit demonstrated.

It is important for the Australian economy as a whole that there is a stable investment environment for the electricity generation industry because electricity generation is an essential input into most other industries. Since the international market for capital is competitive, where possible, the regulatory environment should minimise distortions between industries and between countries. The Merger Guidelines "safe harbours" in Australia and comparable countries are an important feature of a stable investment environment.

It is important for investment certainty in the Australian electricity industry that no change should be made to the application of the Merger Guidelines' horizontal merger safe harbours to the electricity industry without a rigorous analysis to demonstrate how and why differing thresholds should apply to electricity generation compared with other energy and non-energy industries.

5. Given the facts before the Federal Court in the Loy Yang case, Justice French's decision as to geographic markets in the wholesale sector was correct. This decision is consistent with the reality of trading within the NEM, the objectives of the NEM, and NEMMCO's settlement of the market. In addition, it conforms with international treatment of the definition of geographic markets in the electricity industry.

Please do not hesitate to contact me if you have any queries.

Yours sincerely

Dr Robert Wiles  
General Manager, Regulation and Policy

