

23 March 2012

By email: mergers@acc.gov.au

Daniel McCracken-Hewson
Merger Investigations Branch
Australian Competition and Consumer Commission
Level 35, 360 Elizabeth Street
MELBOURNE VIC 300

Dear Mr McCracken-Hewson

Submission re: AGL Energy / GEAC acquisition proposal

We write to provide input into the Australian Competition and Consumer Commission's (**ACCC**) review of the proposed acquisition by AGL Limited (**AGL**) of Great Energy Alliance Corporation Pty Ltd (**GEAC**), which owns Loy Yang Power. Thank you for the offer to provide our comments.

We have not had the opportunity to consider all the questions raised by the ACCC in its letter to interested parties. We also understand that the central question to be considered by the ACCC is whether or not the acquisition is likely to substantially lessen competition in any market. It is important to note that the purpose of effective competition in consumer markets (including energy markets) is to foster good market outcomes for consumers. Given this, we would like to provide comments on:

- the importance of competitive energy markets, given energy is an essential service;
- competition concerns arising from a generator-retailer merger;
- levels of competition in the current Victorian retail energy market;
- current consumer outcomes in the Victorian retail energy market; and
- changes to Victorian energy markets since previous ACCC consideration of this matter.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. We provide free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and are the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

We also operate MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians experiencing financial difficulty.

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Energy and competition

The market for energy is in many ways unique. Energy is an essential service used by all consumers across Australia, supporting fundamental human needs including safe food (storage, preparation) and safe shelter (hygiene, lighting, temperature control). Energy supports equipment that is critical to wellbeing and independence (health, communication). Beyond these fundamentals, energy supports community engagement and family life (social interactions, employment and education).

Given it is clear that energy is an essential service for every individual and not just an economic input, we believe that the ACCC needs to examine this acquisition very closely to ensure there is no substantial lessening of competition.

Competition concerns rising from generator-retailer merger

Energy market acquisitions or mergers may give rise to competition concerns if the vertical reintegration of an upstream or wholesale electricity supplier (i.e. a generator) and a downstream electricity supplier (i.e. a retailer) increases the horizontal market power of the integrated firm in either the upstream or downstream market. This is because the vertically integrated firm may exercise its market power to raise the price of its electricity wholesale contract to foreclose the retail market to rivals or potential new entrants. Put another way, the integrated firm may seek to extend its market power from the wholesale market to the retail market.

A particular concern that should be considered closely is a loss in the liquidity of hedge markets as integrated retailers hedge internally. Such a loss can result in barriers to new retail entry (as it becomes more difficult for new entrants to secure competitively priced contracts) and risk management problems for smaller retailers. A related vertical market power issue comes about when an integrated generator-retailer withdraws from the wholesale market because of the hedge that is created by the merger. The contract market will become 'thinner' post-merger simply because there would be two less participants in that market. Generally speaking, the 'thinner' the contract market becomes, the greater are the incentives for remaining market participants to integrate vertically thereby causing further market concentration. Furthermore, the remaining generators may take advantage of a 'thinner' market to raise the price of wholesale electricity. This would have detrimental effects on all consumers given that wholesale price is a component of end-user prices.

We do acknowledge that there may be efficiency benefits passed onto consumers from generator-retailer mergers, including improved risk management (it provides retailers with a natural hedge against spot market volatility) and reduced transaction costs. However, efficiency benefits may be outweighed by costs associated with diminished competition.

Levels of competition in Victoria's retail energy market

Recent performance reports from Victoria's Essential Service Commission (**ESC**) suggest that retail competition is contracting. In December 2011, the ESC released its energy retail comparative report, which showed that the three leading retailers controlled almost 75 per cent of

the market.¹ Following this report, Consumer Action publicly voiced concerns about implications of the contracting market.² This contraction was largely due to the sale of two NSW retailers to the incumbent retailers, which, since it removed two strong independent retailers which were also operating in Victoria, has had significant implications for competition in the Victorian market.

The chair of the ESC Dr Ben-David has suggested that, at least by some definitions, the Victorian energy market is an oligopoly.³ In the same speech, he outlines some characteristics of oligopolistic markets to include:

inefficient or non-competitive prices; a bunching and a stickiness in price offerings; lack of differentiation in services and products; potential price signalling; low levels of product innovation; a degree of insouciance towards imposed charges and penalties; and maybe even some disregard for the regulator and the regulatory framework.⁴

As part of considering the impact of the proposed acquisition on competition in the Victorian energy market, we think that these matters need to be considered closely by the ACCC.

Current consumer outcomes from Victoria's competitive energy market

In our view, some of the concerns raised by Dr Ben-David are occurring in Victoria. For example, recent regulatory audits undertaken by the ESC indicate some disregard for the regulator and regulatory framework—the ESC has found non-compliance with a range of key consumer protection requirements, and has sought administrative undertakings from a number of retailers.⁵ In letters to some retailers, the ESC noted that this non-compliance is "unacceptable and unsatisfactory". It is worth noting that the regulatory audit for AGL is expected to be completed in March 2012.

The annual performance review referred to above also demonstrates poor consumer outcomes across a number of indicators.⁶ Key indicators demonstrate include:

- Customer service indicators showed a decline in performance in 2010-11. For example, the average wait time to speak to an operator increased from 82 to 101 seconds and the

¹ ESC, Energy Retailer's Performance Review, December 2011, available at: <http://esc.vic.gov.au/public/Energy/Regulation+and+Compliance/Performance+Reports/Energy+retail+comparative+performance+reports+2010-11/Energy+retail+comparative+performance+reports+2010-11.htm>

² Consumer Action, Media Release: Contracting competition in the energy retail market results in lacklustre performance, 19 December 2011, available at: <http://www.consumeraction.org.au/downloads/energyretailersperformancereview-191211.pdf>

³ Dr Ron Ben-David, Speech: Next steps for the regulator of Australia's most deregulated energy market, Essential Services Commission, July 2011, available at: <http://www.esc.vic.gov.au/NR/rdonlyres/57A12EC2-47B3-430E-A565-1AB2309DF2FB/0/NextstepsfortheregulatorofAustraliasmostderegulatedretailenergymarket.pdf>

⁴ Ibid.

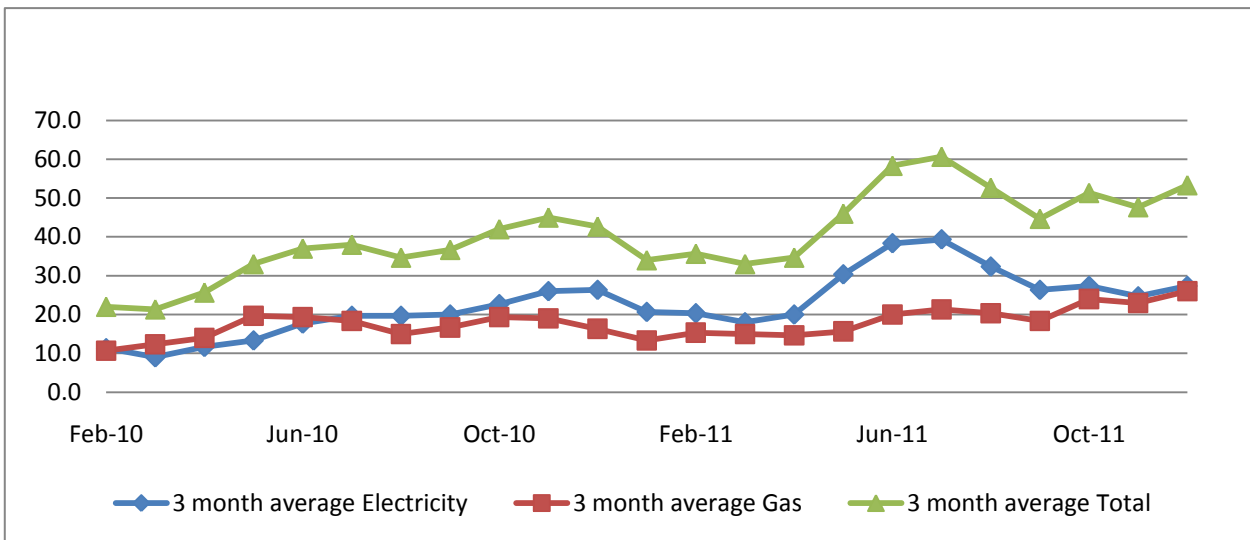
⁵ Essential Services Commission, Summary Reports - Regulatory Audits of Energy Retail Businesses 2010-11, available at: <http://esc.vic.gov.au/public/Energy/Regulation+and+Compliance/Audit+Reports/Summary+Reports+-+Regulatory+Audits+of+Energy+Retail+Businesses+2010-11/Summary+Reports+-+Regulatory+Audits+of+Energy+Retail+Businesses+2010-11.htm>

⁶ Above n 1.

number of calls abandoned increased to 8.5 per cent of all calls to retailers, up from 7.2 per cent in 2009-10.

- The number of complaints recorded by the retailers increased significantly in 2010-11. The number of electricity complaints more than doubled (to 111 047) and gas complaints rose by 50 per cent (to 20 473).
- Participation in hardship programs decreased in 2010-11 with 20 495 customers accessing retailers' financial hardship programs, 3 803 less than in 2009-10.⁷
- Electricity disconnections have increased by 33 per cent in 2010-11 from 0.59 to 0.77 per 100 customers. In total, 17 871 electricity customers were disconnected in 2010-11.

The following graph, prepared by the Victorian Council of Social Service, demonstrates the number of wrongful disconnection cases identified by the Energy and Water Ombudsman Service. The trend is upwards which indicates that retailers are not complying with consumer protections required before disconnecting customers. As disconnection can have a significant impact on the health and wellbeing of vulnerable consumers, this trend is very concerning.



We encourage the ACCC to consider whether further acquisitions in Victoria's energy market will exacerbate competition concerns such that any improvement in consumer outcomes will be inhibited.

Changes since previous consideration

We are aware that the ACCC sought to block AGL's acquisition of part of Loy Yang Power in 2003, but the Federal Court allowed the acquisition to go ahead, despite the ACCC's concerns that it would lead to an increase in electricity prices to electricity retailers in Victoria.

We would like to remind the ACCC of some key changes and differences in the Victorian retail energy market since that time:

⁷ Debt and disconnection figures confirm that this statistic does not demonstrate decreasing instances of hardship, but more the ineffectiveness of retailers' hardship policies at responding to energy hardship needs.

- Since January 2009, retail energy prices are no longer regulated by the Government, and Victorian consumers rely on effective competition at both the wholesale and retail level to keep a downward pressure on retail prices. We encourage the ACCC to closely consider the implications of this merger for particularly retail electricity prices.
- While regulation of energy markets are becoming more national in flavour, there are still state-based markets for retail electricity.⁸ We encourage the ACCC to look closely at market definition, and define a state-based market for residential and small business consumers.

Given the current state of the Victorian retail energy market, we do not think that the ACCC should be guided solely by the Federal Court's reasoning in the earlier consideration.

Please contact me on 03 9670 5088 or at gerard@consumeraction.org.au if you would like to discuss these matters further/have any questions.

Yours sincerely

CONSUMER ACTION LAW CENTRE

A handwritten signature in black ink that reads "Gerard Brody". The signature is written in a cursive, flowing style.

Gerard Brody
Director Policy & Campaigns

⁸ See, eg, the discussion about the differences in the Victorian and NSW retail energy markets in our submission to the Draft Energy White Paper, March 2012, available at: <http://www.consumeraction.org.au/downloads/ConsumerActionSubmissiontoDraftEWPMarch2012.pdf>.