

## Article Information

Service: Competition & Consumer

Sector: Energy & Resources

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## Holding back the tide: ACCC's MacGen determination

**The ACCC has announced it will oppose AGL's proposed acquisition of MacGen's electricity generation assets due to perceived likely anti-competitive effects in the NSW retail electricity market.**

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*The final determination is not yet available, however, the decision follows the line of argument raised in the ACCC's issues paper released on 6 February 2014.*

The ACCC issues paper adheres to conventional structural analysis without much discussion of price performance arising from the excess of supply (generation capacity) over demand (electricity use) in the national electricity market (NEM). According to ACCC figures, an AGL-MacGen merger would produce three large vertically integrated suppliers in NSW:

- AGL-MacGen with 27% of generation capacity and 16% retail load.
- Origin Energy with 26% of generation capacity and 38% retail load.
- Energy Australia with 17% of generation capacity and 33% retail load.

Even accepting the ACCC's analysis that the NSW region of the NEM is a separate market, that would appear to be a competitive market, particularly since supply exceeds demand.

The argument in favour of a separate NSW market is due to limited interconnection capacity at peak load. However, the issues paper does not consider potential competitive effects on interconnection capacity in the event prices were to rise in the NSW region of the NEM relative to other regions. Another possibly contentious aspect is the ACCC's conclusion that there is a separate market for hedge contracts. Perhaps nothing turns on this because the ultimate impact, in the ACCC's view, is to raise barriers to entry in the retail electricity market.

The reasoning favoured by the ACCC is to some extent counterintuitive, given AGL has no retail overlap with MacGen, and raises fundamental issues for consideration by the courts should an appeal be taken. In essence, the perceived harm flows from the vertical integration of MacGen's NSW generation capacity with AGL's NSW retail capacity.

Vertical integration can be justified in economic theory due to transaction cost savings, but competition regulators tend to be sceptical of such benefits. The ACCC notes the tendency over recent years in the NEM towards vertical integration of generation and retail capacity due to the savings in hedging transaction costs that retail business must support. Potentially, therefore, the proposed AGL-MacGen merger would be likely to create pro-competitive efficiencies. However, vertical mergers may also tend to make it more difficult for new competitors to enter the market. It is this possibility that has significantly influenced the ACCC's analysis and it is for this reason that the ACCC wishes to hold back the tide of vertical integration in the sector.

It is ironic that the ACCC has focussed on potential deterrence of new entrants, given that generation capacity exceeds demand in the NEM. This, together with transaction costs associated with the structural division of the NEM between generators and retailers would appear to constitute significant barriers to new entry that would be unaffected by the proposed merger. Nevertheless, the ACCC's objection is based on the potential barrier to new retail entry that may result from perceived reduction in the hedge trading market and hence increased transaction costs for a new retail entrant. AGL offered an undertaking to ameliorate potential adverse impact of the hedge market, however, this was not acceptable to the ACCC. The downside of the ACCC's position is that structural inefficiency, higher transaction costs, and higher prices for consumers could well result from blocking the AGL-MacGen merger.