

	<p style="text-align: right;">CEDA</p> <p style="text-align: center;"><i>Better communicating the ACCC's role, its approach to reviewing mergers involving small retail acquisitions and the benefits of competition in electricity</i></p> <p style="text-align: center;">14 June 2012, Sydney</p> <p style="text-align: center;">Rod Sims, Chairman</p>
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Introduction

I have a great respect for the role CEDA has played and does play in Australian policy thinking, and I am delighted to be again speaking to a CEDA audience.

Today my theme will be improving the Australian Competition and Consumer Commission's (ACCC's) communication. It is crucial, firstly, that any institution such as the ACCC takes responsibility for how it is generally perceived; secondly, that the ACCC explains its actions clearly; and thirdly, that it is seen as a champion of competition and consumer protection, and speaks out accordingly when appropriate.

I think the ACCC, and I, can do more in all three areas. Many people, for example, do not understand our role in a market economy. We are sometimes so focussed on the doing that we do not always explain our actions and, as important, our achievements sufficiently to the public.

Accordingly, today, I want to cover three topics.

1. More widely and effectively communicating our role, and our achievements.
2. Explaining our interest in and approach to mergers in particular involving small retail acquisitions.
3. Stating our views on what constitutes sufficient competition in electricity generation markets.

I will deal with each in turn.

1. More widely and effectively communicating our role, and our achievements

It seems many people believe that the ACCC sets petrol prices. For example, we recently received a letter genuinely suggesting that a fair outcome for consumers as well as the oil companies would be for us to halve petrol pump prices. As this audience knows, Australian petrol prices reflect world prices, the exchange rate and fuel excise. And since our fuel excise rates are low by world standards, so are our petrol prices also low compared to other countries

The disparity that sometimes exists between perceptions of our role and the reality of it can lead some to question the ACCC's powers or, worse, our endeavours. Descriptors such as "toothless tiger", which would surprise many in business, are not uncommon.

In many respects, the ACCC's role should be quite simple to communicate – in short, making markets work for consumers now and in the future. Not by overriding markets but by:

- Maintaining and promoting competition and fixing market failure – by preventing anticompetitive mergers, stopping cartels and intervening when we identify misuse of market power.
- Protecting the interests and safety of consumers and supporting a fair marketplace – addressing misleading behaviour, removing unsafe goods, and tackling unconscionable dealings.
- Driving efficient infrastructure – through industry specific regulation and access regimes.

Much of our role is exercised through the courts or pursuant to a legislative framework. For example, if we see wrong doing or harm in the marketplace, to a large extent, our power comes from the threat of litigation based on evidence acceptable to a court, not from any power of direction based on our view or preferences.

To complete the petrol discussion, as an example of our intervention through the legal framework, we have taken action in the recent past in relation to price fixing behaviour and misleading conduct. Though even here, we are still subject to legal processes, with the Court sometimes disagreeing with our view of a legal issue, as it did in the Ballarat Petrol case where it found that the ACCC had not established an understanding involving one of the parties, because there was no commitment by that petrol retailer to increase its prices in accordance with the price movements of others that were regularly communicated to him.

More recently, we have announced an investigation into price sharing agreements in the retail fuel sector – an investigation that will not be straight forward or free from challenge.

And our communication challenge doesn't stop with an understanding of our role or the framework we operate in, but also covers how we tell the Australian community about the breadth and depth of the issues on our plate.

I was recently speaking to a journalist about an issue concerning supermarkets, always a popular topic. At the end of the interview, to make conversation, the journalist asked

"...so, have you much else on besides supermarkets?"

At the time we just had success against Google and interim relief in relation to Apple, had just finished the Foxtel/Austar merger, and a range of NBN regulatory issues were running, amongst much else.

One of the better illustrations of the breadth and depth of issues that come to us is what our enforcement and compliance area calls the 'funnel'. While it varies from year to year:

- We start with over 160,000 complaints and queries in the year,
- We have a deeper look at 2500 of these,
- We commence 500 or so investigations,

- Around 200 of these progressing to in-depth investigations,
- Resulting in 30 plus court enforceable undertakings, 30 plus court proceedings and now the payment of numerous infringement notices under new laws

But this list does not touch on the countless adjustments to practices and redress to consumers arising from administrative resolutions, education and outreach, and broader compliance campaigns and projects. Indeed, behaviour often changes in response to our enquiries and presence in the marketplace.

I am convinced though that this disparity in understanding of our roles and functions is neither inevitable nor up to others – such as the media – to fix. I strongly believe the ACCC must be a better communicator of our role, and our many achievements. As I said earlier, we must take responsibility for how we are perceived by the wider population.

It is not just enough for us to make good decisions, and to thereby set clear boundaries for business in the marketplace, we need to clearly communicate how our decisions and actions affect consumers.

While I will spare you the full list of recent achievements, I cannot resist briefly mentioning just a very few in the past 9 months.

In the competition enforcement area, for example:

- Woollams – reinforcing the message that price controlling conduct in tenders though cover pricing is illegal – and thereby protecting taxpayer funds in public procurement.
- Ticketek – another one in the series of cases against misuse of market power - heavy sanctions (\$2.5M) making it clear that market power can't be thrown around to block new rivals – ensuring that event organisers have more choices in promoting their shows and consumers benefit from access to discount tickets.
- ANZ and Flight Centre – in two separate proceedings before the federal Court we are tackling the emergence of restraints on competition involving vertical and horizontal supply issues – a chance to make sure competition gets a chance to flourish to the consumers advantage no matter where it emerges. Both matters are yet to be decided by the Federal Court.
- Air cargo – our biggest investigation ever with over \$50M in penalties to date for agreements to impose fuel surcharges rather than allowing competition to set the price – still more to come with a trial scheduled for later this year.

In the consumer enforcement area, for example:

- Google –making it clear that Google and other search engine providers using similar technology will be directly accountable for misleading or deceptive paid search results – returning confidence to consumers on line – subject of course now to a High Court appeal by Google.

- Apple – quick interim relief giving consumers accurate information to inform their choice in new technology - balancing consumers against one of the world's largest companies. The matter remains before the Federal Court.
- Singtel Optus – the largest civil pecuniary penalties in a consumer case to date - saying enough to complicated conditions and limitations not properly disclosed that interfere with consumer choice.
- Hooker meats (where products were branded “King Island beef”) and other premium claims– taking on things that matter to consumers – recognising that great weight is given to premium claims that consumers – and competitors – should expect to be accurate.
- Door to door energy cases – drawing a line in the sand when it comes to sales practices at a consumer’s home – a place where we should expect the best behaviour but perhaps have seen some of the worst – a chance to clean this up across the board.
- Carbon price representations – protecting consumers from those who seek to blame a grab for higher than justified prices on a new policy initiative.

In the important area of product safety, for example:

- Trade quip – stopping traders from supplying non-compliant hydraulic trolley jacks – a product that needs to be up to scratch and carry all the right warning to prevent injury or worse.
- Teeth Whitening recall – getting products off the shelf that had the potential to cause real harm to everyday consumers.
- Cotton On – court action to drive home the importance of compliance with safety and labelling requirements for kids nightwear – it is a bit hard to overestimate the importance of these actions.

As I said above, however, our outcomes do not stop at the Court room door. In fact, more is achieved through out of court action. At the more formal level, we were quick to start using new infringement notice powers with many issued over the last two years, and we continue to accept a range of court enforceable undertakings which lock traders in to fixing the problem at hand. For example:

- Olive Oil – infringement notices paid in response to ACCC tests showing claims of Extra Virgin were not backed up – consumers deserve what they pay for.
- Foxtel – infringement notices paid totalling \$46,200 for running a nationwide advertising campaign that the ACCC believed was misleading through fine print – an issue consumers often complain about..
- Noonkambah – watching out for behaviour that can emerge in remote communities where they might be considered out of sight – in this case - false or misleading conduct in relation to selling some products well beyond ‘best before’ dates and displaying shelf prices that were lower than the actual purchase prices.

And the matters that often go completely under the radar – in large part because many are behind the scenes – we affect hundreds and thousands of business’

behaviours and practices through agreements to change conduct, heeding our warnings, or adjust through education.

Our work in scams is perhaps one of the best examples with a recent project tackling some of the dangers of fraudulent behaviour on dating and romance websites. We have also done a lot of work in relation to unfair contract terms.

- Goodwin – the ACCC intervened following a complaint within its retirement village where a document could have been considered unfair under the unfair contract term provisions.

Our work in rolling out new consumer guarantee laws – strengthening and clarifying a consumers right to products that work – saw a combination of education activity, trader engagement and follow-up investigations designed to empower and protect consumers.

This very selective list illustrates the ACCC's role in a way that is of interest to Australians generally. I have not, of course, mentioned our recent merger, authorisation or regulatory activity.

I suspect many Australians would be surprised to hear the above list. These activities yield direct benefits, as specific behaviour is stopped and, much more important, indirect benefits as other businesses learn what behaviour to avoid and the boundaries within which they can trade.

The ACCC will be doing more in future to explain our role and our achievements. Those who fund us have a right to know what they are getting for their hard earned taxes.

2. Explaining our interest in mergers involving small retail acquisitions

The ACCC's online merger register is followed closely not only by the finance press and trade practices community but also by the wider business world. It is scrutinised, for example, for signs that the ACCC may be taking a different approach in terms of the types and numbers of acquisitions it reviews but also the time these reviews take.

Most recently it has been the ACCC's reviews of "small" retail acquisitions—in some cases involving single stores—that have raised queries as to why the ACCC is devoting time and resources to acquisitions which, some argue, have little overall effect in the Australian economy. This theme has progressed to questions being raised such as

"Does this mean the ACCC will want to review an acquisition by one butcher shop of another in a country town?"

Such questions highlight the importance of using forums such as CEDA to communicate these aspects of the ACCC's approach to mergers.

Looking at the ACCC's mergers register, it is true that there are a number of current reviews underway that involve 'small retail acquisitions' in the liquor, grocery and home improvement sectors. While these acquisitions may seem small relative to a

global merger of, say, two mining companies, they are important at both the local and at the national level. Let me explain.

The national chains are increasing their participation in the liquor, grocery and home improvement sectors, particularly through many small acquisitions. This ownership trend benefits from substantial economies of scale and scope in, for example, distribution logistics centres and advertising as well as brand promotion.

Barriers to entry for other chains or buying groups to replicate the strong market position of Wesfarmers and Woolworths, are becoming increasingly high. Added to this often are local barriers associated with, for example, access to sites.

When the major supermarket chains (MSC) acquire an independent player they remove an alternative from the market, with potentially a different product range and service offering. This reduces consumer choice as well as, for example, competition generally if the number of players in a local market were to reduce from, say, four to three much less three to two. That competition is unlikely to be replaced by either a chain or a new independent given local and/or national entry barriers.

There is also another issue.

Wesfarmers and Woolworths already have significant market power in groceries, and may move to a similar position in liquor, home improvement and even petrol with frequent small acquisitions of existing outlets, or indeed, greenfield land sites.

There is no provision in our legislation to cap market shares or to take account of previous acquisitions when reviewing the competitive effect of the next transaction—that is, there is little or no scope to consider the accumulated effect of a series of separate acquisitions over time and instead we can only consider the competitive effect of each transaction. This means the ACCC's focus will in many cases primarily be limited to analysis of the local market effects given that the acquisition of one store is unlikely to result in a substantial reduction in competition at the national or regional level.

With a number of markets at the state/national level already being quite concentrated the ACCC is concerned to ensure that further acquisitions in local markets do not ultimately lead to retail or indeed wholesale industry structures that may adversely affect the competitiveness of these markets and reduce choice for consumers.

The ACCC is already concerned about the market structures in the supermarket sector and the continued expansion of Coles and Woolworths relative to the other retailers. While it recognises that growth by the major supermarket chains has brought benefits to consumers as a result of their scale, there is a risk that with only two major national chains, competition between them to offer lower prices and better service will be 'softer' than it might otherwise be.

Because of these concerns, the ACCC has been paying increased attention to incremental acquisitions in the grocery, liquor, home improvement and petrol sectors to identify which acquisitions require review and, of those, which raise competition concerns.

We can be seen to be at a critical decision point. Either we can ignore the many current local acquisitions by Wesfarmers and Woolworths and in, say, five years see what market structure we have in key sectors. Or we can examine each local

acquisition now, as best we can and within our legislation, to see if there is a substantial lessening of competition.

The ACCC is choosing the latter course.

It is, of course, important not to exaggerate what we can achieve. To oppose an acquisition we must believe we can convince the Federal Court, that it will substantially lessen competition in a market/s. Many such small acquisitions will, therefore, be approved.

By opposing those acquisitions which substantially lessen competition in a local market, however, we hope to not only assist local communities, by protecting competition, but also ensure better national market structures than would otherwise emerge.

This week alone has seen one local transaction approved, but another withdrawn after the ACCC raised serious competition concerns. Our reviews have taken considerable time as acquisitions which raise competition concerns, whether they be large or small transactions, involve complex issues of market definition and competition analysis.

In recent years, there has been an informal and cooperative arrangement in place between the ACCC and Wesfarmers and Woolworths regarding the supermarket transactions they would notify to the ACCC. There is, of course, no legal requirement for them to do this.

With the revised focus I have just outlined we are now actively engaging with Woolworths and Wesfarmers to expand these arrangements to cover a wider range of acquisitions and sectors. We are proposing improved arrangements that we hope will bring mutual benefit.

In return for advanced notice of a wider range of acquisitions, and for particular information being provided upfront with each transaction, we would establish a dedicated team to assess these transactions within specified times. This way Wesfarmers and Woolworths would certainly know quickly whether we have significant concerns or not with a particular acquisition.

These discussions have just begun and it remains to be seen whether or not these arrangements can be implemented. For our part we do not intend to comment further until our discussions with Wesfarmers and Woolworths are completed.

With repeated transactions in local markets we believe our processes can be streamlined. This can, however, only occur with appropriate notification, co-operation and upfront information.

Unless and until some new arrangements are put in place, however, our review of those local acquisitions we become aware of will continue under current processes. My comments at this time are made to explain our current actions and focus, and to show that there are ways to address the current delays in reviewing acquisitions in local markets.

3. Stating our views on what constitutes sufficient competition in electricity generation markers.

An important role for the ACCC is to communicate the importance of competition in promoting the long term interests of Australian consumers. As the competition regulator, we are in a unique position to raise issues about market structure—drawing governments and businesses attention to the significance of getting market structures right as a first best option, rather than subsequently regulating markets that are not competitive.

This is why I have raised the issues of market structure and levels of competition in the electricity generation market generally, and in respect of the NSW electricity market in particular, following the recent announcement of the prospective privatisation of NSW generation.

There is much to be said for the privatisation of commercial assets. In many ways the private sector is the natural owner of them given the nature of decision making required.

It is always tempting for governments, when privatising assets, to maximise the sale proceeds. To do so at the cost of an inappropriate market structure, however, is to trade off higher proceeds now for, in this case, higher electricity prices later.

Alternatively, if privatisation achieves a competitive market structure, NSW consumers can benefit from lower electricity prices in the future as a result of the successful privatisation.

The generation market on the Eastern seaboard of Australia, called the National Electricity Market or NEM, has special characteristics that make it prone to the exercise of market power. For this reason, the ACCC must be particularly vigilant when assessing generation mergers and, therefore, State Governments must also be vigilant in setting up competitive structures when they privatise their assets.

To understand the factors that make generation prone to the exercise of market power, it is worth thinking about what limits market power in other markets. In other markets, if a company attempts to raise its price by restricting its output, customers may reduce their demand for the product; they may switch to other products, or switch their consumption to other times. Competitors will expand production or product might be imported.

In electricity, on the other hand, things are quite different. Electricity cannot easily be stored and much electricity consumption cannot easily be diverted from one point in time to another.

Wholesale demand for electricity tends to be very inelastic. Very few consumers respond to the wholesale price for electricity by moderating their demand. In addition, generating units cannot easily increase their output once they reach capacity, so the supply curve for electricity tends to be very steep at peak times. The wholesale price is also extremely volatile, with prices at around \$40 per megawatt hour for the vast majority of the time, but at times reaching the price cap of \$12 500 per megawatt hour and at other times falling to \$-1000 per megawatt hour. There is also no option but to purchase energy from the market as participation is compulsory.

As a result of these factors, relatively small changes in the supply curves, for example if a generator exercises its market power, can lead to very large changes in prices. Prices can jump up several hundred times from one time interval to the next.

Even though peak demand times are relatively rare, only a few hours of wholesale prices close to \$12,500 per megawatt hour is enough to have a very significant impact on the annual average price. While in the short-term, most consumers do not feel these prices, because they have retail contracts that protect them from the volatility, in the medium to long-term, high wholesale prices do flow onto all end consumers.

Theoretically, the interconnectors, which are transmission links between the states, constrain market power within a state by facilitating imports when prices are high. Taking NSW as an example, based on name-plate capacity, the import links into NSW can flow over 3000 megawatt from Victoria and Queensland, which is equivalent to almost 20% of the entire NSW generation industry.

However, unfortunately the interconnectors do not have the constraining effect that those figures imply. Close analysis of the data shows that whenever the price in New South Wales is significantly higher than its neighbouring regions—which is those times when one would hope the interconnectors flow at maximum capacity—actual import capacity into NSW is closer to 700 megawatts. This also limits retailers' ability to enter into financial hedges with generators outside NSW. The ability of the interconnectors to constrain market power is therefore quite limited.

So, looking further at NSW generation privatisation, a pretty clear picture emerges of there being 5 existing significant players, Macquarie, Delta, Snowy Hydro, Origin via its gentrader contract, and TRUenergy via its gentrader contract. Macquarie, with over 4800MW of capacity, is easily the largest generator in NSW. At times of high demand in NSW (or reduced supply options from other generators), Macquarie must be dispatched in order to meet demand. Macquarie therefore has the ability to set the price at peak times. As I noted earlier, the ability to set the price can mean pushing it up more than hundred times typical average prices.

The NSW Government is in a unique position and has a one-off opportunity to influence the level of competition in NSW generation in the future. Restructuring Macquarie into separate portfolios, rather than selling it as a single entity, will limit the exercise of market power in NSW in the future.

Likewise, so will ensuring there is a wide range of electricity generation ownership. These steps will ultimately assist in keeping electricity prices lower for NSW consumers by ensuring a more efficient and competitive wholesale market in the long term.

Conclusion

I believe the ACCC must be an effective communicator on all issues.

You will see us in future seeking to explain our role and achievements better, to explain our approach where appropriate and to give our views on relevant competition issues.