

COMPETITION & REGULATORY

LEGAL UPDATE

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MCE sparks electricity reforms

Radical changes to the regulation of the electricity industry are close at hand with the imminent release of the National Electricity Law (NEL) for public comment.

Key message

Industry has little time to comment on sweeping changes to electricity regulation.

The draft amendments to the NEL - foreshadowed by the Ministerial Council on Energy (MCE) - are expected to be available next month, before being introduced to Parliament in late October or November.

Key amendments to the NEL are set to include:

- » handing over economic regulation of electricity distribution to the Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC) from 1 January 2007
- » the introduction of a limited merits review scheme for specific economic regulatory decisions in electricity, based on the May 2006 decision of the MCE
- » a common approach to network pricing and revenue across the energy market - covering pricing principles and regulatory guidance - based on the MCE's forthcoming response to its expert panel's report of April 2006
- » the strengthening of consumer advocacy by the creation of an independent panel answerable to the AEMC.

Retail price control is expected to stay with the States and Territories unless they choose to transfer their powers to the AER and AEMC.

Amendments to the Australian Energy Market Agreement were endorsed by the Council of Australian Governments at the beginning of this month. The agreement lays down the cooperative scheme between Commonwealth, State and Territory governments for national energy regulation and provides the basis for implementing the electricity reforms.

In addition to the upcoming reforms, the MCE has announced the development of a legislative package for introduction in 2007 that will allow the transfer of regulation of non-economic distribution and non-price functions to the AER and AEMC.

These changes are just part of the path of reforms that have altered the face of the electricity industry in the past year. The NEL replaced the old Code in July last year and two brand new bodies, the AER and the AEMC, emerged to regulate the national electricity market in conjunction with the Australian Competition and Consumer Commission (ACCC).

Working within the ACCC - but an entity in its own right - the AER has been operating as a self-described "one-stop shop for energy regulation". It monitors and enforces compliance with the NEL and has the power to issue on-the-spot fines of up to \$20,000 for a breach. Rule making powers in the national electricity market now rest with the AEMC, while the ACCC continues to regulate mergers and anti-competitive conduct in the industry.

How do the reforms affect you?

The public consultation period for the changes to the NEL will be from late July, and it is expected that the amended NEL will be introduced into the South Australian Parliament in October or November. This means that industry participants have a limited time to comment on the legislative package and will need to work quickly to make submissions.

The public consultation period is an opportunity for market participants to ensure that their experience and interests are considered before the amendments are made.

In the meantime, participants in the electricity market should be aware of the extensive powers of the AER, including the power to issue on-the-spot fines for breaching the NEL. Participants can reduce the risk of breaching the NEL through compliance systems that:

- » are integrated in the day-to-day practices of a company
- » enable risks to be identified, analysed, monitored and communicated
- » contain guidelines for avoiding breaches or minimising the effect of breaches that have already occurred.

Exposure drafts of the amendments to the NEL will be available from July. Check the MCE website at www.mce.gov.au or contact us.

Lynsey Edgar | Graduate

Structural divestiture secured ACCC's clearance of Toll's acquisition of Patrick

The final version of Toll's section 87B undertakings, which were accepted by the ACCC, shed light upon how to obtain an informal clearance of an acquisition which involves horizontal and vertical integration with key infrastructure.

Key message

In proposed acquisitions which involve horizontal and vertical integration linked to key infrastructure, the ACCC is more likely to accept section 87B undertakings which require a clear structural divestiture of assets and interests (rather than mere behavioural undertakings) to address relevant competitive concerns.

On 11 March 2006, the ACCC discontinued its proceedings to prevent the proposed acquisition by Toll Holdings Limited (**Toll**) of Patrick Corporation Limited (**Patrick**), after it accepted Toll's fifth version of court-enforceable section 87B undertakings.

Section 50 of the *Trade Practices Act 1974* (Cth) prohibits acquisitions that would have the effect or likely effect of substantially lessening competition in a market. If the ACCC believes that a merger will breach section 50, it can apply to the Federal Court to seek remedies such as an injunction to prevent the merger. Where there is a risk of raising section 50 concerns, parties can apply to the ACCC for an informal clearance or authorisation of the merger. The parties can submit undertakings to alleviate any competition concerns raised by the ACCC's market inquiries into the merger.

The ACCC's Public Competition Assessment released on 5 May 2006 outlines how Toll's subsequent structural undertakings (in conjunction with its behaviour undertakings) satisfied the ACCC that the proposed acquisition of Patrick would not have the effect or likely have the effect of substantially lessening competition in the transport and logistics industry.

Background

Toll and Patrick are providers of transport and logistic services, which includes freight forwarding and line-haul services by road, rail, sea and air, and integrated logistics and distribution services. Patrick is also a provider of port stevedoring operations. Both providers are part of a 50-50 joint venture in Pacific National, one of Australia's largest providers of interstate rail container line-haul services.

In August 2005, Toll launched a hostile offer to take over Patrick. Given that this would result in Toll's 100% control of Pacific National, the ACCC was concerned that the effect of the proposed acquisition would be to substantially lessen competition across several markets in the transport and logistics industry.

Market definition

Toll argued that the acquisition would create logistical efficiencies in Australia. However, as Toll was vertically integrated and a 100% control of Pacific International would mean Toll could control the east-west rail freight and freight forwarding market, there would be flow-on effects of Toll discriminating against rival transport and logistic providers across the road, rail, sea and airline networks. It could also increase barriers to entry and expansion across the markets.

Accordingly, the ACCC had to define each market and examine how the proposed acquisition would affect competition in each.

Federal Court action

The ACCC and Toll were engaged in months of deliberations whereby Toll provided 4 versions of undertakings pledging not to discriminate and favour its own businesses over other players in the market. These undertakings did not alleviate ACCC's competition concerns because Toll remained in control of significant assets and infrastructure across several markets in the industry. The ACCC requested that the acquisition not proceed, but Toll refused to comply.

On 9 February 2006, the ACCC commenced proceedings in the Federal Court to seek an injunction to prevent Toll from acquiring Patrick and any of Patrick's businesses, assets

or affairs. It also sought a declaration that the proposed acquisition would contravene section 50.

Undertakings

It was not until the Federal Court action that Toll offered a fifth version of its proposed undertakings which provided, for the first time, a structural divestment undertaking. The main undertakings included:

- » divestment of 50% of shares in Pacific National to an ACCC-approved entity
- » divestment of interests in Patrick's Bass Strait shipping and freight forwarding operations, Patrick or Toll's vehicle transport operations and the Minto siding terminal
- » relinquishing east-west train paths and trains to assist a new or existing operator to obtain access to certain terminals and tracks
- » commitments that Pacific National will not favour Toll's downstream interests in its future business activities
- » commitments that Patrick would not favour Toll or Patrick's land-side logistic operations.

Of major importance was Toll's undertaking to divest 50% of Pacific National. The structural and behavioural undertakings satisfied the ACCC that Toll would:

- » not gain an additional ability to influence the activities of Pacific National to anti-competitively discriminate against competitors in favour of its own operations and interests
- » facilitate the further entry of operators or expansions into the rail and shipping line-haul and freight-forwarding markets and automotive distribution services market
- » prevent the removal of vigorous competitors in the shipping, automotive

distribution services, and pre-delivery and inspection services market.

Accordingly, the ACCC discontinued its proceedings against Toll.

The structural undertakings, though complex and inter-related, addressed the concerns the ACCC had of enforcing and monitoring the behaviour of a player which, without the undertakings, would otherwise control a substantial proportion of assets and infrastructures in a market. It was further satisfied that Toll's 50% capped ownership of Pacific National and the court-enforceability of the undertakings ensures that adequate pressure can be applied by Pacific National shareholders, competitors, customers and suppliers to ensure compliance with the undertakings.

Significance

This acquisition highlights that, in complex cases involving vertical and horizontal integration with key infrastructure and flow-on effects to competition in inter-related markets, the mere provision of behavioural undertakings are unlikely to alleviate the ACCC's competition concerns. In these circumstances, the ACCC will look to asset divestments and structural undertakings in order to satisfy itself that the acquisition would not substantially lessen competition.

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Dawson amendments – third time lucky?

*It is almost three-and-a-half years since the Dawson Committee released its report recommending substantial changes to the **Trade Practices Act 1974 (Cth)**. The Bill to enact the Dawson Committee recommendations has been presented to Parliament twice without success. Its history is not encouraging.*

2004	The amendments recommended by the Dawson Committee first come before Parliament in the form of the Trade Practices Legislation Amendment Bill 2004. This Bill was allowed to lapse due to the October 2004 federal election.
17 Feb 2005	The Trade Practices Legislation Amendment Bill (No 1) 2005 (2005 Bill) is introduced into the House of Representatives.
10 Mar 2005	The 2005 Bill is passed by the House of Representatives and introduced into the Senate.
11 Oct 2005	Senator Barnaby Joyce crosses the floor to vote with the Opposition parties to reject the reforms relating to mergers and collective bargaining contained in the 2005 Bill. The effect of his vote is to sever the sections dealing with mergers and collective bargaining from the rest of the 2005 Bill. The remainder of the 2005 Bill was passed by the Senate.
Jun 2006	As the 2005 Bill was effectively amended by the Senate, it has been returned to the House of Representatives. Due to the stalemate over the Bill in the Senate, the Government has not set a timetable for its progression.