The Senate

Economics
Legislation Committee

Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009 [Provisions]

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Chapter 1

Introduction

1.1 The Trade Practices Amendment (Material Lessening of Competition—Richmond Amendment) Bill 2009 was introduced into the parliament by independent Senator Nick Xenophon on 26 November 2009. The bill will amend section 50(1) of the *Trade Practices Act 1974* (TPA) with the aim of:

- strengthening Australia's anti-merger law; and
- addressing the issue of creeping acquisitions.

1.2 In terms of mergers, the bill intends to introduce a lower threshold by replacing the current test in section 50(1) of the *Trade Practices Act (1974)* (TPA) of a 'substantial' lessening of competition with a 'material' lessening of competition.

1.3 In terms of creeping acquisitions, the bill intends to prevent a corporation that already has a substantial share of a market from acquiring shares or an asset which would have the effect of lessening competition in the market.

1.4 These two issues—mergers and creeping acquisitions—are closely linked. The drafter of the bill has noted that unless the TPA effectively prevents creeping acquisitions, 'there will be a considerable gap in the Act allowing large businesses to acquire competitors in a piecemeal manner that gets around the existing prohibition against mergers in section 50(1)'.[1] The effect will be that the merged entity will be able to raise prices to the detriment of consumers.

Mergers and creeping acquisitions

1.5 A merger is combination of two or more firms or corporations such that one is absorbed into the structure of the other(s) and loses its separate identity.[2] The value of merger and acquisition activity in Australia in 2009 is estimated at over A$174 billion.[3]

1.6 Companies merge for various reasons, including:

- to improve their efficiency by realising economies of scale and economies of scope;
- to increase their market power (and hence profits);
- as a defensive strategy to make the company less likely to become a takeover target itself; and

1 Associate Professor Frank Zumbo, *Submission 14*, p. 6.

2 Butterworths Encyclopaedic Australian Legal Dictionary

3 Treasury, *Submission 15*, p. 1. Treasury gives the figure of US$160 billion.

- a management strategy seeking the greater prestige and salaries that come from running a larger organisation.

It is only if the first reason is dominant that mergers may be in the public interest rather than just in the interests of managers.[4]

1.7 However, merger activity may also impact adversely on competition, by concentrating market share and increasing the likelihood of price gouging. Competition (or anti-trust) laws regulate the extent to which companies are allowed to merge.

1.8 The TPA does not refer explicitly to a 'merger'. Rather, section 50 (1) and section 50(2) of the TPA prohibit either a corporation or a person from directly or indirectly acquiring shares in the capital of a body corporate or any assets of a person, 'if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market'. This test has been in operation since 1993.

1.9 Section 50(3) of the TPA provides a non-exhaustive list of matters that must be taken into account in determining whether there has been a substantial lessening of competition in a market. These are:

a. the actual and potential level of import competition in the market;

b. the height of barriers of entry to the market;

c. the level of concentration in the market;

d. the degree of counterveiling power in the market;

e. the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices and profit margins;

f. the extent to which substitutes are available in the market or are likely to be available in the market;

g. the dynamics of the market including growth, innovation and product differentiation;

h. the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and

i. the nature and extent of vertical integration in the market.

1.10 In Australia, the merger process is subject to both the provisions of section 50 of the TPA and formal and informal merger review processes. The Trade Practices Legislation Amendment Bill (No. 1) 2005 introduced a formal merger review process whereby parties can apply to the Australian Competition and Consumer Commission (ACCC) for clearance in respect of proposed acquisitions of shares or assets. If a

4 See Senate Economics References Committee, *Report on Bank Mergers*, September 2009, http://www.aph.gov.au/Senate/committee/economics_ctte/bank_mergers_08/report/report.pdf

clearance is granted by the ACCC, then section 50 does not prevent the acquisition of shares or assets.[5]

1.11 In addition, the ACCC operates an informal merger review based on its Merger Guidelines. Although they have no legal force, these Guidelines are a useful public guide to section 50 and the Commission's approach to its enforcement.

1.12 'Creeping acquisitions' refer to circumstances in which companies substantially lessen competition not by single large acquisitions but by incremental smaller acquisitions over a period of time. Each of these small acquisitions is not in breach of section 50, and the series of acquisitions are therefore permissible by law.

1.13 There are currently no provisions in the TPA to prevent or limit 'creeping acquisitions'. For some time, there has been discussion as to whether the existing merger provisions of section 50 are adequate to deal with 'creeping acquisitions' or whether specific provisions are needed.

Context of the inquiry

1.14 This inquiry is at least the fourth federal parliamentary committee inquiry that has considered the issue of creeping acquisitions. Three previous inquiries all considered that some action was necessary to prevent creeping acquisitions:

- in 1999, the Joint Select Committee on the Retailing Sector made a series of recommendations in response to creeping acquisitions concerns in the grocery sector. The committee observed that mandatory notification of acquisitions to the ACCC 'may expose more clearly whether a major chain is implementing a deliberate strategy of creeping acquisitions';[6]
- in 2004, the Senate Economics Committee recommended as part of its inquiry into the effectiveness of the TPA in protecting small business that provisions should be introduced into the Act to ensure that the ACCC has powers to prevent creeping acquisitions which substantially lessen competition in a market. The committee recommended that the TPA's divestiture powers in section 81 should be expanded to apply to contraventions of section 46, section 46A 'or any new section introduced to regulate creeping acquisitions';[7] and
- in 2008, the Senate Economics Committee considered a private members' bill from Family First Senator Steve Fielding which proposed an amendment to

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5 See T. John and J. Davidson, Trade Practices Legislation Amendment Bill (no 1) 2005, *Bills Digest*, Parliamentary Library, no. 130, 2004–05.

6 Joint Select Committee on the Retailing Sector, 'Fair Market or Market Failure?', August 1999, p. 58.

7 Senate Economics Committee, *The effectiveness of the Trade Practices Act in protecting small business*, March 2008, p. xix. Section 81 currently enables divestiture where a merger contravenes section 50 or 50A.

the TPA so that an acquisition would be deemed to lessen competition substantially if it and other acquisitions over the previous six years would have that effect. In response the committee recommended that the Senate defer consideration of the bill 'until the Government's legislation regarding this topic is presented'.[8]

- Coalition Senators considered that while the bill is 'meritorious', 'strong consideration should be given to exploring superior alternatives in preventing creeping acquisitions…through the enactment of a divestiture power'.[9]

The government's announcement

1.15 In January 2010, the federal government announced that it will amend the TPA 'to deal with creeping acquisitions'. The proposal is to give the ACCC the power to reject acquisitions that would substantially lessen competition in any local, regional or national market. In order words, a proposed acquisition could be rejected whether it substantially lessens competition in a local downstream market (retailing) or in a broader upstream market (wholesaling).

1.16 Currently, section 50(6) of the TPA requires that the relevant 'market' must be a substantial market for goods and services in Australia, a state or territory or a region of Australia. The Trade Practices Amendment Act (No. 1) 2001 amended the TPA to include a substantial market in a region of Australia, thereby extending the existing section which referred only to a substantial market for goods and services in Australia or in a state or territory of Australia. This amendment was recommended by the 1999 Joint Parliamentary Committee (see above).

1.17 The ACCC's Merger Guidelines note that in any particular merger case, it will be a matter of judgement as to whether the market is considered to be substantial. The Guidelines explain that the:

> …substantiality of a market is not necessarily related to geographic size. A market may be small geographically (for example, a local market) but may also be substantial within the region in which it is located. Alternatively, a market for the supply of a product that is an essential but small ingredient in the production of one or more other products sold in large markets may be considered substantial.

1.18 The Minister for Competition, the Hon. Dr Craig Emerson, has noted that some 'private legal opinion' has questioned whether the ACCC has the power to consider effects on competition in local markets. He argued that the government's intent was to clarify that the ACCC—in deciding whether an acquisition would

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8 Senate Economics Committee, *Trade Practices (Creeping Acquisitions) Amendment Bill 2008*, p. 9.

9 Senate Economics Committee, *Trade Practices (Creeping Acquisitions) Amendment Bill 2008*, August 2008, p. 11.

substantially lessen competition—can examine the market on either a national, regional or local market.

1.19 In addition, the Government proposes to ensure that the ACCC can examine the acquisition of greenfield sites and not just existing businesses. There have been some queries as to whether the ACCC has the power to review acquisitions of greenfield sites. In particular, the government's intent is to ensure that the ACCC can review acquisitions by the major supermarket chains of interests in new sites to investigate whether such acquisitions could substantially lessen competition.

1.20 At the time of writing, the Government's proposed legislation on creeping acquisition had not been introduced into the Parliament.

Conduct of the inquiry

1.21 On 30 November 2009 the Senate referred the bill for inquiry and report by 18 March 2010. On 24 February 2010 the Senate granted an extension of time for reporting until 13 May 2010.

1.22 The committee advertised the inquiry in *The Australian* newspaper and on the committee's website. It also wrote to stakeholders, inviting written submissions by 18 December 2009. The committee received 15 submissions, which are listed in Appendix 1.

1.23 The committee held a public hearing in Adelaide on 9 April 2010 where it took evidence from Treasury officials and officers from the Australian Competition and Consumer Commission, among others. Appendix 2 lists those who appeared at this hearing.

1.24 The committee thanks all who participated in this inquiry. It particularly thanks Senator Simon Birmingham for substituting at short notice during the public hearing.

Structure of the report

1.25 This report is divided into the following chapters:

- the example for the bill—the case involving Mr William Fares and how the bill relates to his situation;
- the basis for the bill—that the ACCC approves nearly all merger applications;
- the bill's proposals to:
  - (a) replace the phrase 'substantially lessening competition' with 'materially lessening competition' in sections 50(1) and 50(2) and;
  - (b) address creeping acquisitions by ruling that a corporation which already has a substantial share of a market must not directly or indirectly merge with or acquire shares or an asset which would have the effect of lessening competition in the market; and
- a concluding chapter on the committee's view of the legislation.

Chapter 2

The Fares case

2.1 This chapter looks at the case of independent service station owner Mr William Fares. Mr Fares has been the owner and operator of the United service station at 128 Marion Road in West Richmond (Adelaide) for the past 20 years. Last year, Woolworths expressed interest in acquiring land next door to Mr Fares' business.

2.2 The Trade Practices Amendment (Material Lessening of Competition—Richmond Amendment) Bill 2009 was drafted by Senator Nick Xenophon in response to situations such as that of Mr Fares. As Senator Xenophon explained in the Second Reading Speech:

> The Richmond Amendment takes its name from the Adelaide suburb of West Richmond, where, for the last twenty years, William and Samira Fares have owned and operated their independent United service station. Now, they face losing their business because Woolworths has sought to open a service station of their own, right next door. Under current laws, Woolworths can use their deep pockets to offer fuel at prices that are below cost or which undercut hard working independent petrol retailers like the Fares. Woolworths can even choose to operate their station at a loss, knowing that once the Fares are out of business, Woolies can once again raise their prices. With no local competition to force Woolies to moderate their prices, residents of West Richmond will end up paying at the pump for Australia's lax competition laws.[1]

2.3 Mr Fares gave evidence to the committee in Adelaide on 9 April 2010. He told the committee that:

> If a Woolworths site ends up being next door to us then I am pretty sure that within no time, three months, six months or whatever it might be, that our doors will close. That is what I believe because they can afford to go as low as they can.[2]

2.4 On 13 April 2010, the West Torrens Council gave planning approval for Woolworths' proposal. The development assessment panel, which passed the proposal 5–1, identified that competition was a relevant factor in its decision.[3]

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1 *Second Reading Speech*, 26 November 2009.

2 Mr William Fares, *Proof Committee Hansard*, 9 April 2010, p. 2.

3 Adelaide Now, 'Council approves Woolworths service station next door to independent', 5 May 2010, http://www.adelaidenow.com.au/news/south-australia/council-approves-woolworths-service-station-next-door-to-independent/story-e6frea83-1225853800089 (accessed 5 May 2010).

2.5 A Woolworths spokesperson was reported as saying that 'the existence of other petrol-filling stations within the surrounding area is not relevant to an assessment of the planning merits of the current application'.[4] It was also reported that Woolworths spokesman, Mr Luke Schepen, explained that Woolworths was trying to 'bring competition to the market'. He added:

> We place stations where we think they'll best serve customers. In this case, we're looking to bring convenience and competition for local motorists.[5]

Predatory pricing or creeping acquisition?

2.6 Prima facie, Mr Fares' situation seems, potentially, to relate more to the issue of predatory pricing than creeping acquisitions. The concern is that Woolworths may use its market power to undercut the United station's prices, thereby forcing Mr Fares out of business. Woolworths could subsequently increase both its prices at that location and its market share. This type of action is predatory pricing and is prohibited under section 46 of the Trade Practices Act (TPA).[6]

2.7 The drafter of this legislation, Associate Professor Frank Zumbo, has argued that the Fares case does relate to creeping acquisitions. He noted that section 50 of the TPA 'prohibits a corporation or a person from directly or indirectly acquiring shares of a body corporate or any assets of a person, if the acquisition has the effect or likely effect of substantially lessening competition in a market'. In this context, he observed that an asset includes leases and options, which in the Fares' case is the land adjacent to its business.[7]

2.8 It should be noted, however, that Mr Fares does not *own* the adjacent land. The obvious case of a creeping acquisition would be if Woolworths decided to buy the Fares business directly. It could either do this outright and pay the prevailing market price, or it could set up next door to Mr Fares and undercut his prices (or credibly threaten to do so) with a view to devaluing the market price of his business, before acquiring it cheaply.

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4 'Woolies fuel fight sparks cost warning', 10 April 2010, http://www.adelaidenow.com.au/news/south-australia/woolies-fuel-fight-sparks-cost-warning/story-e6frea83-1225852023860 (accessed 5 May 2010).

5 Adelaide Now, 'Council approves Woolworths service station next door to independent', 5 May 2010, http://www.adelaidenow.com.au/news/south-australia/council-approves-woolworths-service-station-next-door-to-independent/story-e6frea83-1225853800089 (accessed 5 May 2010).

6 See Senate Economics References Committee, T*rade Practices Amendment (Predatory Pricing) Bill 2007*, 1 August 2007, http://www.aph.gov.au/Senate/committee/economics_ctte/completed_inquiries/2004-07/trade_practices/report/tp_pred_price/index.htm

7 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 23.

The role of the ACCC

2.9 With Woolworths having received planning approval to set up a service station on Marion Road, the ACCC's interest will be in whether the company uses its market power to eliminate Mr Fares' business. As Dr Phillip Williams, a member of the Law Council of Australia's Trade Practices Committee, told the committee:

> [Woolworths'] motivation is undoubtedly to make money. It is very likely that they will see that by entering and cutting prices they are going to eliminate some of the local people. The real issue is whether they are able to charge lower prices because of their efficiency or whether they are able to charge lower prices because of some advantage that has nothing to do with efficiency but has more to do with market power. That is really the fundamental issue for any antitrust authority. If the ACCC were of the view that the only reason they are able to eliminate Mr Fares is because of their market power, then they should bring an action under section 46. It would infringe section 46.[8]

The impact of the bill in Mr Fares' case

2.10 The following chapters will consider the effect of the proposed legislation in terms of the threshold for section 50(1) cases generally. The committee also heard evidence as to how the bill may affect Mr Fares' situation specifically.

2.11 Associate Professor Zumbo was asked his view on how the bill would assist in Mr Fares' case. He told the committee:

> The creeping acquisitions provisions of this bill would capture not only acquisition of shares, but would capture the acquisition of assets, which include leases and options. There would be a question of whether Woolworths has a substantial market share—it is a local market test—and whether that would then lead to a lessening of competition. There would be consideration of the impact of Woolworths acting unilaterally when they take over that site, but also the coordinated effects of Woolworths being in that market in the sense that they will coordinate with other large players in the market.[9]

2.12 However, Mr Tim Grimwade of the ACCC expressed doubt as to whether the bill would even apply to Mr Fares' situation given that Woolworths may not have 'a substantial market share' of the local market. He argued that the local market:

> …might be a three-to-five kilometre radius, and there are a large number of competitors to Mr Fares even within a three-kilometre radius. You would have to question whether Woolworths indeed had a substantial market share if the market is the local market in which Mr Fares operates, because there are, as I understand it, in a five kilometre radius around 15 different

8 Dr Phillip Williams, *Proof Committee Hansard*, 9 April 2010, p. 16.

9 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 23.

> operations represented by maybe 35 sites. I think Mr Fares referred to 35 sites. I am not sure about that. So, Woolworths might have 10 per cent or 11 per cent within a five-kilometre radius. Whether that amounts to a substantial market share I would question. I am not sure whether this particular provision…would even really deal with this particular situation.[10]

2.13 Dr Phillip Williams, a member of the Law Council of Australia's Trade Practices Committee, argued that the bill may have the unintended consequence of limiting the option of a large competitor directly acquiring Mr Fares' business at a good market price. He explained:

> Let us suppose Woolworths were on a knife edge between deciding whether they buy his business or whether they try to get a licence to open up next door…Presumably that is because they really have a strong preference to open up next door rather than to acquire his business. He would much prefer that they acquire his business. I was thinking that, if this amendment became law, it may well be that the law would bias them in favour of opening up next door rather than acquiring his business, and for this reason. Let us suppose that they have the necessary market share in order to knock over that hurdle, then the question would be: which of those two alternatives would be more likely to be found to be lessening competition—opening up next door and competing with him or acquiring his business and having that area to itself? My guess is the second would be much more likely to be found to be lessening competition than the first. I am not sure that the amendment would help Mr Fares. In fact, I think it might well make his situation worse.[11]

2.14 Mr Fares himself confirmed his preference for Woolworths to buy out his business, rather than have them set up next door. He was asked whether there was any possibility that Woolworths might set up next door and then offer to buy his business. Mr Fares responded:

> If they wanted to do that then why did they not just come in and say, 'We want your site for a service station', like they have done in the past. But they are not interested in that…They could have used the opportunity to walk in and say, 'We're interested in opening a service station here. Are you prepared to lease it out or sell out?' We would have probably said yes. I would prefer to sell out and not have competition from Woolworths next door to me.[12]

2.15 Associate Professor Zumbo suggested that for a large company such as Woolworths, the option of setting up next door to a smaller competitor will often be more attractive than buying them out. He told the committee that:

10 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 29.

11 Dr Phillip Williams, *Proof Committee Hansard*, 9 April 2010, p. 16.

12 Mr William Fares, *Proof Committee Hansard*, 9 April 2010, p. 2.

> Traditionally…Woolworths or Coles…would go in and offer to buy out that independent, and many independents have taken that offer. If the independent said no, then they would open up next door.
>
> …
>
> Over time I suspect a large player…may take the view, 'Why would I give the Fares' any money for their business when I could simply open up next door? I save myself the money of buying out the Fares'. I would have to do up the Fares's site, anyway, because it is branded a different oil company name. I would have to spend money revamping the site. I might as well start afresh. I can save myself the money of paying out the Fares, which I can use to develop the site next door, up the road or wherever it is, and then I use pricing practices to drive out that independent.[13]

Committee view

2.16 The issues discussed in this chapter have raised areas of concern for the committee.

2.17 Firstly, the committee questions whether Mr Fares' situation is, in fact, indicative of a possible section 50 creeping acquisitions case. Having received council approval to build at the site in West Richmond, it would seem that any possible anti-competitive conduct on the part of Woolworths would fall under the predatory pricing provisions of section 46. This is because—if Woolworths was to use its market power anti-competitively—it is more likely that it would price the United Services station out of business rather than acquire it.

2.18 Secondly, the committee is concerned that the bill would disadvantage people like Mr Fares, whose preference is to be bought out by a large competitor for a good price rather than have the competitor move in and price them out of the market. The bill would encourage large competitors with substantial market share to set up next to small competitors rather than take them over because a direct acquisition would be more likely to lessen competition.

13 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 23.

Chapter 3

The premise of the bill

3.1 This chapter focuses on the claim made by the drafter of the legislation that the need for action on creeping acquisitions reflects the Australian Competition and Consumer Commission's (ACCC) highly permissive approach to merger applications.

The high rate of merger approval

3.2 The principal argument put by the proponent of the bill to amend section 50(1) is that the current rate of merger approvals by the Australian Competition and Consumer Commission (ACCC) is too high. Associate Professor Frank Zumbo argues that the ACCC approves 97 per cent of all merger and acquisition applications and that as a result, 'Australia has some of the most highly concentrated markets in the world'.[1]

3.3 In evidence to the committee, Associate Professor Zumbo explained how the figure of 97 per cent was calculated:

> In the year 2008-09 there were 412 mergers considered. The number not opposed outright was 397; opposed outright, 10. When I get to around the 97 per cent figure I look at the number totally opposed outright. On that number, 10 out of 412, you get 97.57 per cent. There is a further category—and I add this for the sake of clarification—that says 'applications resolved during review through undertakings'. That represents a further five cases. That is a case where the ACCC has raised concern and the parties have given undertakings to the ACCC that satisfy the ACCC. That is a further five. Even if you add that further five as having been stopped by the substantial lessening of competition test, then that is a further one per cent. That takes you down to roughly 96.57 per cent. So, the 97 per cent number is looking at the opposed outright, but I do accept that there is some flexibility and I am happy to throw in those extra five or that extra per cent and you are still around 97 per cent.[2]

Criticism of this analysis

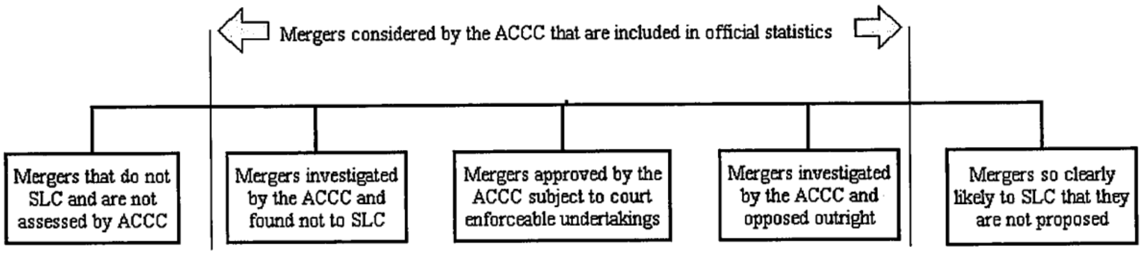
3.4 Both Treasury and the ACCC have queried Associate Professor Zumbo's analysis. The following section canvasses their respective arguments.

1 Associate Professor Frank Zumbo, *Submission 14*.

2 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 19.

Treasury's analysis

3.5 In its submission, Treasury noted that the percentage of mergers opposed and not opposed is not a good measure of the effectiveness or application of the merger test because some merger matters are not included in the official statistics.



3.6 Treasury's submission included the above diagram by way of illustration. The boxes on the far left and far right of the spectrum represent those merger categories that are excluded from the official statistics.

3.7 The far left box represents those mergers that do not substantially lessen competition and are not assessed by the ACCC. A large proportion of the merger matters that are considered but not opposed by the ACCC are referred to it by the Foreign Investment Review Board (FIRB) or the Australian Prudential Regulatory Authority (APRA) or by the merger parties as a matter of courtesy. These do not raise competition concerns.

3.8 The far right box represents those mergers so likely to substantially lessen competition that they are not proposed. These mergers are prevented by section 50(1) 'even though they are not recorded as having been proposed by the ACCC'.[3]

3.9 The three middle boxes are those mergers that are considered by the ACCC and are either found not to substantially lessen competition, are approved subject to enforceable court undertakings or are opposed outright.[4]

3.10 Associate Professor Zumbo did note that the mergers included in the official statistics and those so 'likely to substantially lessen competition that they are not proposed' are more likely to arise in concentrated markets. He told the committee that in a highly fragmented market, the parties are unlikely to go to the ACCC unless they want 'a letter of comfort'.[5]

3.11 Nonetheless, the key point to make is that if those mergers in highly fragmented markets represented in the far left box were included in Professor Zumbo's calculations, the merger approval figure would be significantly less than 97 per cent.

3 Treasury, *Submission 15*, p. 2.

4 Treasury, *Submission 15*, p. 3.

5 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 19.

3.12 The ACCC was also critical of Associate Professor Zumbo's merger approval statistic of 97 per cent. Mr Tim Grimwade of the ACCC told the committee that the figure of 97 per cent cannot be a meaningful measure of the effectiveness of the test. He gave three main reasons why this is the case.

3.13 First, it does not take into account the nature of the matters that the ACCC reviews. Specifically, there are many merger clearance requests—'between 100 and 200 a year'—referred to the ACCC by the FIRB. The vast majority of these raise no concerns 'because they relate usually to a new entrant coming in and buying an asset or business in Australia'. Mr Grimwade noted that these instances:

> …clearly would inflate the denominator, if you are going to start using a 97 per cent statistic to measure the effectiveness of the test.[6]

3.14 Second, there are matters that do not require review and important sub-categories among those that do require a review. The ACCC explained that in this financial year it has sought to distinguish between pre-assessed mergers that do not require any review and those that do. In the 2009–2010 financial year, about 120 merger requests have been pre-assessed without any review, leaving 'about 118' that require review.[7] Of those requiring review:

- some are opposed outright;
- some are accepted that would otherwise have been blocked but for a remedy being proposed and accepted by the commission; and
- some are put for review but 'withdrawn before we give our final decision'. There were 'around 21' of this category last year and 'another 10 already' this financial year.[8]

These categories accord with the three middle boxes in Treasury's diagram (above).

3.2 Third, the ACCC emphasised that there is no legal obligation by parties to notify the Commission of a merger proposal. Instead, the ACCC structures and incentivises notifications 'to capture a really large number of mergers' in order to ensure that it can block any anticompetitive merger. Mr Grimwade explained:

> If we had a mandatory notification process—and we have given it some thought—it would have all sorts of adverse consequences. For instance, it would send a signal to those that do not meet the notification thresholds—because you have to have a threshold for notification—that perhaps their merger is okay when in fact it might not be.[9]

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6 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 27.

7 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 27.

8 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 27.

9 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 28.

3.3 The ACCC was asked its view as to how many mergers and acquisitions are prevented by the substantial lessening of competition test. Mr Grimwade gave the following response:

> …having regard to the matters that we review, leaving aside the matters we do not review that we pre-assess do not require review, and you include the matters we oppose, the matters we would have opposed but for accepting a remedy or the matters that were withdrawn, you end up this financial year looking at about 77 per cent, I think. I think it is a furphy to use a statistic like that to make such a big decision on changing a test of this function effectively for two decades that is consistent with international best practice and has largely generated very good outcomes for the Australian economy.[10]

International comparisons

3.15 Ms Julie Clarke of Deakin University has argued that the approval of roughly 95 per cent of merger proposals notified to the ACCC in any given year does not necessarily mean that the 'substantial lessening of competition test' is set too high. Indeed, she noted in her submission to the inquiry that this:

> …percentage is consistent with the percentage of notified mergers challenged in most other OECD jurisdictions. In the United States, for example, the percentage of notified mergers challenged is routinely lower than that challenged in Australia. This statistic simply reflects the fact that the vast majority of mergers do not raise competition concerns. It does not imply that the law itself is too lenient.[11]

3.16 Associate Professor Zumbo told the committee that comparisons of merger approvals between Australia and the United States must be seen in context. He explained:

> Our concern in Australia is that our markets are getting even more concentrated and quickly so. If you have a 97 per cent approval rating in the United States, which is a much bigger market, it takes a lot longer to get to the level of concentrations that you have in Australia if it is the same approval rating of 97 per cent. We need to look at each country on its own merits, as we have to look at each merger on its own merits.[12]

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10 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, pp 31–32.

11 Ms Julie Clarke, *Submission 6*, p. 2.

12 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 21.

Chapter 4

The bill's amendments

4.1 This chapter analyses the arguments for and against the bill's two key provisions.

Replacing 'substantially' with 'materially'

4.2 The bill proposes replacing the word 'substantially' with 'materially' in sections 50(1) and (2). The Explanatory Memorandum (EM) notes that:

> …a "material" lessening of competition test would lower the threshold for determining whether a merger or acquisition is anti-competitive and would allow the merger or acquisition to be tested by reference to whether it has *a pronounced or noticeably adverse affect on competition*, rather than on whether the merged entity would be able to exercise substantial market power post-merger, as is currently the case.[1]

4.3 The ACCC's Merger Guidelines (2008) note that:

> The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgement and will always depend on the particular facts of the merger under investigation. Generally, the ACCC takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices.[2]

Arguments for replacing 'substantially' with 'materially'

4.4 In his submission to this inquiry, Associate Professor Zumbo argued that the bill's proposed amendment of 'a material lessening of competition' would allow the merger or acquisition to be tested by reference to whether it has 'a pronounced or noticeably adverse effect on competition' and consumers.[3] He envisaged that this test would focus attention on whether or not the merger or acquisition would lead to a reduction in the number of efficient competitors in the marketplace and whether such a reduction would reduce the diversity or range of goods and services available to consumers.

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1 *Explanatory Memorandum*, p. 1. Emphasis added.

2 ACCC, *Merger Guidelines*, 2008, p. 11.

3 Associate Professor Frank Zumbo, *Submission 14*, p. 5.

4.5 Associate Professor Zumbo noted that the concept of materiality 'is not a foreign concept' and is referred to in the International Competition Network's recommended practices for merger notification procedures.[4]

Arguments against replacing 'substantially' with 'materially'

4.6 Several submitters to this inquiry claimed that changing the wording in subsections 50(1) and 50(2) to a 'material' lessening of competition would create confusion and uncertainty.

4.7 The Law Council of Australia argued that the existing 'substantial lessening of competition' threshold in section 50(1) is a 'well understood test' that is reflected in the competition regimes of comparable jurisdictions.[5] It claimed that the bill's proposed change to this test would 'create uncertainty, undermine existing legal practice and discourage investment in Australian business'. The Council also expressed concern that if the threshold in section 50(1) is amended, there would be uncertainty as to the application of the 'substantial lessening of competition' tests in sections 45 and 47 of the TPA.[6]

4.8 In evidence to the committee, Mr Stephen Ridgeway of the Law Council's Trade Practices Committee, articulated his concerns with the use of the word 'materially' and the benefit of retaining the word 'substantial' in the context of section 50:

> The committee does not see how the substitution of ‘materially’ for ‘substantially’ in the key threshold test in section 50 will have any beneficial effect…The…main concerns about materiality are that we do not have an established case law on what it means. It has only recently been introduced into the act in part 3A with a promotion of material increase in competition and that is yet to be interpreted. Otherwise, we have a test which has been in since 1993, is internationally accepted as the standard and is well understood by business both here and overseas. So there is a concern as to what would be achieved by changing the current test, other than to introduce uncertainty.[7]

4.9 The Law Council's submission noted that the EM does not define 'materially', and nor is it defined in the TPA. There is no case law or use of the term 'materially' in overseas competition law from which to derive its meaning in competition law in Australia. The Council did note a New Zealand High Court decision which equated the words 'material' and 'substantial'. However, the federal government's 2004

4 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 25.

5 Law Council of Australia, *Submission 2*, p. 1.

6 Law Council of Australia, *Submission 2*, p. 2. See also Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 12.

7 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 12.

response to the Productivity Commission Report on the Review of the National Access Regime defined 'materially' as 'less than substantial'.[8]

4.10 Treasury emphasised that it would be unclear as to how the bill's threshold of 'materially' would be interpreted by the courts. It noted that:

> …it is conceivable that a court may interpret 'material' as being a far lower threshold than 'substantial', which may have the effect of prohibiting many mergers which would have been allowed to proceed under the present test, or that it may instead interpret 'material' as being almost indistinguishable from 'substantial', meaning that the amendment may have little practical effect.[9]

4.11 Treasury argued that in the absence of a clear definition of 'material', it is difficult to assess whether the amendment strikes an appropriate balance between the achievement of positive benefits from merger activity while preventing competitive detriment.[10]

4.12 Ms Clarke observed that the meaning of the word 'substantial' in the context of section 50(1) of the TPA has not been judicially determined. It was considered in this context in *Australian Gas Light Company V Australian Competition and Consumer Commission No. 3* [2003] FCA 1525 where Justice French related 'substantially' to 'meaningful or relevant to the competitive process'. Ms Clarke noted the recent comment of Professor Stephen King that 'materially' has been at times defined by the courts as being synonymous with 'substantially'.[11]

4.13 Ms Clarke also critiqued the EM's claim that the word 'materially' would allow mergers to be assessed on whether they have a pronounced or noticeably adverse affect on competition rather than the current test of whether the merged entity would be able to exercise 'substantial market power'. This claim, she noted, appears to have been based on the ACCC's Merger Guidelines. However, these are not binding and appear nowhere in the Act. Moreover, she argued that:

> [T]here will be limited, if any, circumstances in which competition will be harmed in a 'pronounced or noticeable' way in the absence of an increase in market power of the kind described in the Guidelines.[12]

4.14 In Treasury's view, the current legislation provides an 'appropriate framework' for the assessment and consideration of mergers by the ACCC and the courts. It noted that the test of 'substantially lessen competition' is 'consistent with merger laws in

8 Law Council of Australia, *Submission 2*, p. 6.

9 Treasury, *Submission 15*, p. 7.

10 Treasury, *Submission 15*, p. 7.

11 Ms Julie Clarke, *Submission 6*, p. 3.

12 Ms Julie Clarke, *Submission 6*, p. 3.

many other OECD countries including the US, Canada, UK and New Zealand'.[13] Further, no other comparable jurisdiction has introduced a test based on a 'lessening' of competition without further clarifying the quantum of the 'lessening' to be prohibited. Treasury has noted given the increasing number of cross-border mergers, consistency with overseas laws should be a consideration in opposing the bill's amendments.[14]

4.15 This point was also raised by Ms Clarke. She noted that:

> A change to the Act in the way proposed would generate uncertainty for business at a time when the increasing incidence of transnational mergers requiring review in multiple jurisdictions has triggered a desire for international consistency of merger regulations whenever practical.[15]

A 'creeping acquisitions' test based on market share

4.16 The bill's other provision is to amend section 50 such that a corporation which already has a substantial share of a market must not directly or indirectly merge with or acquire shares or an asset which would have the effect of lessening competition in the market. The intent is to correct the current situation where companies can circumvent section 50 by:

> ...undertaking small scale acquisitions which individually do not appear to substantially lessen competition, but which over time do result in a lessening of competition and the increased dominance of the merged entities.[16]

Arguments for a creeping acquisitions provision

4.17 Associate Professor Frank Zumbo argued in his submission to this inquiry that the issue of creeping acquisitions arises because the current drafting of section 50(1) is 'far too permissive'.[17] Specifically, section 50(1) refers to an 'acquisition', in the singular—unless a given acquisition in itself substantially lessens competition it will not be in breach of section 50. Accordingly, he argued that piecemeal acquisitions can—and do—circumvent the anti-merger laws, giving the examples of the Commonwealth Bank's acquisition of Bank West and Westpac's acquisition of St George.[18]

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13 Treasury, *Submission 15*, p. 1.

14 Treasury, *Submission 15*, p. 4.

15 Julie Clarke, *Submission 6*, p. 2.

16 *Explanatory Memorandum*, p. 1.

17 Associate Professor Frank Zumbo, *Submission 14*, p. 6.

18 Associate Professor Frank Zumbo, *Submission 14*, p. 6.

Arguments against the bill's creeping acquisitions provision

4.18 The Law Council of Australia argued in its submission that the bill's proposal for a new test to account for small scale acquisitions is 'problematic and inappropriate'.[19] It cited several reasons:

- first and most fundamentally, it claimed that it is not clear what a 'substantial share of a market' would be;[20]
- second, the use of a 'lessening of competition' test would alone risk prohibiting any acquisition by a firm with substantial market share. Given that any acquisition would have an effect on competition that is 'nominal, insignificant or irrelevant', the Law Council argued that the provision would establish a de facto market share cap for companies in Australia (see below);[21]
- third, market share is not in itself a good indicator of the dynamic nature of competition. The Law Council noted that the limitations of relying on market share and competition analysis are clearly recognised by the ACCC in its current merger guidelines;[22]
- fourth, the concept of substantial market share is 'unsound' in the context of section 50. The Law Council argued that given the established approach to the meaning of 'substantial' in section 50, the bill's provision would extend to any company with a market share which was not 'insignificant' or 'nominal'. Even firms with relatively small market shares would be prohibited from making acquisitions;[23] and
- fifth, the merger threshold test of a 'substantial lessening of competition' has worked well in comparable jurisdictions. Treasury noted in its submission that the 'substantially lessening competition' test is 'serving Australia well for the majority of merger cases and that any consideration of changes should be based on sound evidence of a problem'.[24]

A market share 'cap'

4.19 The Law Council was one of several submitters who were critical that the bill would effectively impose a market share 'cap'. They emphasised the following three problems.

4.20 First, market share cannot be equated with market power. A firm may have a substantial degree of power in a market even though its market share in that market is

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19 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 12.

20 Law Council of Australia, *Submission 2*, p. 2.

21 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, pp. 12–13.

22 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, pp. 12–13.

23 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, pp. 12–13.

24 Treasury, Submission 15,

quite low. Conversely, a firm with high market share can hold little or no market power and acquisitions by those firms can lead to no competitive detriment.[25]

4.21 Treasury recognised that section 50(3) of the TPA identifies market concentration as a factor that the ACCC and other competition agencies consider in assessing the likely competition affects of a proposed merger (see paragraph 1.9). However, it emphasised that market concentration is only one of a number of considerations and that opting to focus solely on market share may obscure the true competition effects of a merger.[26]

4.22 Mr Tim Grimwade of the ACCC explained to the committee the regulator's concerns in using a test of market share to assess merger applications. He noted that:

> There are, for instance, mergers that will lead to a high level of concentration or a substantial market share which will not be substantially anticompetitive or indeed anticompetitive. The issue in merger review is to assess the level of constraint imposed on a merged entity. That is how we detect and elicit the extent to which a merger is going to be anticompetitive. Having a substantial market share test does not enable you to capture that…
> …Having a substantial market share is not necessarily indicative of their having market power that would warrant what the bill suggests, a lower threshold, a lessening of competition rather than a substantial lessening of competition test. That is really where our concern sits. The substantial market share is not an effective reference to market power.[27]

4.23 The second concern is that the bill's provision on creeping acquisition will create uncertainty given it is a 'significant departure' from the current approach.[28] Setting a percentage market share as a benchmark would be an arbitrary exercise with practical problems.

4.24 Treasury noted that if the threshold was set at 20 per cent, many mergers which do not breach the current section 50 may be prohibited and section 50(1) would be irrelevant. On the other hand, if the threshold was set at 80 per cent, the provision would be unlikely to block many mergers that would not already be blocked under section 50(1).[29]

4.25 Ms Julie Clarke observed that:

> [R]igorous economic analysis is required to determine first what the relevant market is and then what market share is held by the merging parties and other participants. Economists can and will differ in their views on each of these issues, generating considerable uncertainty for business.

25 Treasury, *Submission 15*, p. 8.

26 Treasury, *Submission 15*, p. 8.

27 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 28.

28 Treasury, *Submission 15*, p. 8.

29 Treasury, *Submission 15*, p. 9.

> Once this analysis is conducted merging parties must predict whether or not the ACCC or the courts will consider the share that they hold within the market to be substantial.[30]

4.26 The third problem with a market share 'cap' is that it would have adverse consequences for companies and the economy at large. Many modest-sized firms in a local market with a market share in excess of the 'cap' would be prevented from efficiency-enhancing and pro-competitive acquisitions. The 'cap' would also prevent many small business owners from selling their business because they would have fewer potential bidders and could therefore face a reduced sale price.[31]

4.27 The 2003 Dawson Review of the competition provisions of the TPA also cited these anti-competitive consequences as the basis for its opposition to a market share cap. Ms Clarke highlighted this finding in her submission noting that 'the reasoning of the Dawson Committee on this point remains sound'.[32]

4.28 Associate Professor Frank Zumbo has countered criticism that the bill would impose a market share 'cap'. He noted in his submission that 'there is no mention of any so-called "cap" in the Richmond Amendment'. Rather, the bill proposes a prohibition of anti-competitive mergers in the same way that the current section 50(1) prohibits certain mergers: 'the only difference is that the Richmond Amendment would be triggered at a lower threshold than the current s 50 of the Trade Practices Act'.[33]

30 Ms Julie Clarke, *Submission 6*, pp. 4–5.

31 Treasury, *Submission 15*, p. 9.

32 Ms Julie Clarke, *Submission 6*, p. 4.

33 Associate Professor Frank Zumbo, *Submission 14*, p. 12.

Chapter 5

The committee's view

5.1 This chapter gives the committee's view on the three issues of key concern relating to this legislation. The first—the basis for the bill—is the claim that nearly all merger applications are approved and section 50(1) is too permissive. The second and third issues relates to the two key provisions of the bill: replacing the word 'substantially' with 'materially' in section 50(1); and the additional prohibition on acquisitions by companies that have a substantial share of the market where that acquisition is likely to have the effect of lessening competition.

The mergers approval rate

5.2 Chapter 3 discussed the relevance of Associate Professor Frank Zumbo's claim that the ACCC approved nearly all (97 per cent) merger and acquisition applications in 2008–2009. It detailed both the Treasury's and the ACCC's critique of this claim.

5.3 The committee agrees that Associate Professor Zumbo's claim is misleading. It excludes mergers that are not assessed because they do not substantially lessen competition and those that are not proposed because they so clearly have this effect. It also includes the many routine merger clearances that come to the ACCC through the Foreign Investment Review Board as a matter of courtesy. If these factors were taken into account, the merger approval estimate would be significantly less.

5.4 The committee therefore does not regard the statistic that the ACCC approves 97 per cent of a subset of possible merger applications as in itself constituting proof that the merger regime in Australia is too permissive. But nor does criticism of the statistic imply that the regime is appropriate. A closer look at whether the degree of market concentration which the regime has allowed to emerge is desirable would be a sounder basis for making such a judgement.

Replacing 'substantially' with 'materially'

5.5 Chapter 4 noted the potential for disagreement by the courts in the interpretation of the phrase 'materially lessen competition'. Associate Professor Zumbo claimed the word would set a lower threshold than 'substantially lessen competition'. However, various submitters argued the interpretation—and therefore the impact—of the word 'materially' would be uncertain and would create confusion. They claim there is a possibility that 'materially' may in fact set a higher bar than 'substantially' in the context of section 50(1), or the words may be interpreted synonymously.

5.6 The committee believes that the concept of 'substantially lessening competition' has been well-established both in Australia and overseas. It is deliberately imprecise and vague to enable adaptation to the circumstances of particular cases.[1]

A market share 'cap'

5.7 Chapter 4 also discussed the bill's creeping acquisition provision. Associate Professor Zumbo claimed that a prohibition from further acquisitions based on a corporation's existing market share is necessary to prevent companies from circumventing the current provisions of section 50(1). The bill's critics argue that setting a percentage market share threshold would be both arbitrary and contentious. If the threshold were set too low, it would prevent small firms from merging to increase their efficiency and competitiveness. Even with a moderate threshold, there is a risk that a market share provision would stop small business people from gaining a good price for their business.[2]

5.8 The bill's critics go too far, however, in saying the bill sets an absolute market share 'cap'. It only limits firms from increasing their market share through takeovers, not by providing cheaper or higher quality goods and services.

5.9 The Government announced in January 2010 that it intends to introduce legislation that will clarify that a 'market' as defined in section 50(1) relates to a national, regional or local market. It is unclear as to whether this amendment would have any significant ramifications or whether the 'substantial lessening of competition' test in section 50(1) is already applied to a local market by the ACCC and the courts.

Conclusion

5.10 The committee believes that the bill should be rejected. The committee argues that the existing test of 'substantially lessening competition' in section 50(1) has been interpreted by the courts and it is important not to alter this test with a term that is uncertain in both its legal meaning and application. Moreover, any change to this test must be based on sound evidence of a problem, which in the committee's opinion, the proponent of the bill has not provided (see chapter 3).

5.11 In terms of creeping acquisitions, the committee rejects the bill's proposal to prohibit a firm with a substantial market share from acquiring shares or asset than has the effect of lessening competition. Setting a percentage market share threshold would be both arbitrary and contentious. Moreover, if set too low, the threshold may prevent relatively small firms with a sizeable share of a local market from merging to increase efficiency and competitiveness.

Recommendation 1

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1 See Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 13.

2 See the Hon. Chris Bowen, 'Reviewing Federal Government's Amendment to the Trade Practices Act 1974', Keynote Address to the 4th Annual Trade Practices and Corporate Compliance Summit The Grace Hotel, , 28 April 2008.

5.12 The committee recommends that the Senate reject the bill.

Senator Annette Hurley
Chair

Dissenting Report from Senator Xenophon

Introduction

1.1 The Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment) Bill 2009 seeks to strengthen sections 50 (1) and 50 (2) of the *Trade Practices Act 1974* by tightening the test for proposed mergers or acquisitions, and to prevent 'creeping acquisitions'.

1.2 The Bill was introduced in part in response to the case of small business owners, William and Samira Fares, who have owned and operated an independent United service station in the Adelaide suburb of West Richmond for the last twenty years.

1.3 In late 2009 the Fares were notified that supermarket giant, Woolworths, who currently shares 44 percent of the petrol market and 80 of the dry packaged goods market with its direct competitor, Coles, applied to lease the land adjacent to the Fares on Marion Road, and submitted plans for a service station to be built on this site.

1.4 The impact of this aggressive tactic, the Fares' believe, will result in them being priced out of business and forced to close.

> "If a Woolworths site ends up being next door to us then I am pretty sure that within no time, three months, six months or whatever it might be, that our doors will close. That is what I believe because they can afford to go as low as they can."[1]

1.5 The Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment) Bill seeks to address instances such as these, where corporations who already hold a substantial share of a market would be prevented from acquiring shares or an asset (in this case, leasing land) that would have the effect of lessening competition in the market.

1.6 While the ACCC has an existing 'substantial lessening of competition' threshold which it has applied to merger and acquisition cases since 1993, under the current test and those put to the ACCC, around 97 percent of mergers and acquisitions are approved.

> This leads some parties to argue that the test does not adequately protect small business operators from predatory acquisition strategies by big business.

[1] William Fares, Proof Committee Hansard, 09 April 2010, pg 2

> Indeed, Woolworths, Coles and the major oil companies control 93 percent of the retail petrol market, leaving just 7 percent to be shared between independent operators.

1.7 All submissions and witnesses to the Inquiry agree that competition is vital to ensure a fair market, however the key focus has to be on the need for fair competition, not at the expense of small businesses that are not only crucial to Australia's economy as a whole, but which are essential to a competitive market so as to produce the best possible result for consumers.

The case study

1.8 William and Samira Fares have owned and operated the independent United service station on Marion Road in West Richmond for the last twenty years.

> "It is a service station workshop … We rely on the sales of petrol and what we do through the workshop to pay the rent, pay the workers and pay everything else."[2]

1.9 Both William's parents and Samira's parents owned service stations (in Victoria and in South Australia) and they both worked at their parents' businesses on weekends, in the same way their three children work with them today.

1.10 When the Fares bought the land, it was a closed site with the nearest service station located 1.5 kilometres away.

> **Senator XENOPHON**—What sort of competition do you have in your area? In other words, how many other service stations are there within a small radius of your area?
>
> **Mr Fares**—It is pretty fair competition, I believe. Each site is about 1.5 to two kilometres away. That was the understanding when you first purchase a service station when there was actual Fuel Board licensing where you could not reopen a service station or be within certain kilometres of another service station. That is the guarantee why we outlaid that sort of money.[3]

1.11 The concern of the Fares', and the foreseen risk to their business, is that Woolworths will be able to price its petrol and store products well below the Fares, thanks to its market power in these sectors.

In his statement tabled to the Committee, William Fares shared:

> "My family and I rely on one income – selling fuel. Woolworths has many income streams – it could sell below cost for months in one retail space and not feel it because they can make up for it elsewhere. And while we do have loyal customers and the community knows us by name, if the service

[2] William Fares, Proof Committee Hansard, 09 April 2010, pg 2

[3] William Fares, Proof Committee Hansard, 09 April 2010, pg 2

station next door is selling its fuel at 4 cents, 8 cents or 10 cents cheaper than us, then of course they're going to go there. And this is the problem. Woolworths is able to sell their fuel that low. Quite simply, the power that Woolworths has and the income it has will allow it to cut prices that I simply can't match."[4]

1.12 It is important to recognise that this case has the propensity to be replicated nationally.

> **Senator EGGLESTON**—What do you see as the future of small family businesses like your own who are faced with competition from these companies like Woolworths who have such a large market share in Australia? What do you see as the future of small business?
>
> **Mr Fares**—There will not be a future.[5]

Mr Fares also said in his statement:

> "I understand Australia has around 1.5 million trading small to medium sized businesses. I am just one of them. But what's happening here could happen to any other small business owner, and that's a scary thought."[6]

The threat to competition

1.13 Under current laws, Woolworths can use its extensive market power to, firstly, buy fuel at lower than normal wholesale costs, and secondly offer fuel at prices which undercut the prices of independent petrol retailers like the Fares'.

> **Senator XENOPHON**—Is it the case that as an independent operator sometimes the petrol that is being sold at Coles and Woolworths is actually lower than the wholesale price you can get it at. Is that your understanding?
>
> **Mr Fares**—It is a fact. The fuel that they buy is way under. Every week we are actually losing money to compete when they drop down to that level. For instance, our buying price yesterday was $1.22 and we were selling it at $1.19, so we were losing 3c a litre just to compete because Woolworths was $1.18. If you do not do that then no-one comes in, so there is a bit of competition when you look at it in that circumstance.[7]

1.14 Further, Woolworths could operate its service station at a loss for a period of time, knowing that once the Fares are out of business, they can once again raise prices.

As the Law Council of Australia pointed out in its submission to the Committee,

[4] William Fares, Statement tabled to the Committee, 09 April 2010

[5] William Fares, Proof Committee Hansard, 09 April 2010, pg 2

[6] William Fares, Statement tabled to the Committee, 09 April 2010

[7] William Fares, Proof Committee Hansard, 09 April 2010, pg 2

"[Woolworths]' motivation is undoubtedly to make money. It is very likely that they will see that by entering and cutting prices, they are going to eliminate some of the local people."[8]

1.15 The Retail Traders Association of Western Australia shared this concern in its submission to the Committee:

The Association is aware that small business has [also] expressed concern that acquiring corporations may engage in anti-competitive behaviours. Such behaviour could utilise market power to a level impossible to compete with, causing smaller competitors either to close or sell to the larger corporation. Larger corporations are often able to cross-subsidise and achieve far better pricing within a market through their volume purchasing.[9]

1.16 The State Retailers Association of South Australia argues that:

"… the over-riding problem really is that Woolworths and Coles now dominate to the point that no government is brave enough to say "enough is enough!" You're market share (80% +/-) has reached the point where the oligopoly so created is in fact anti-competitive, anti small business and not in the best interests of Australian consumers."[10]

1.17 And, as the National Association of Retail Grocers of Australia argues in its submission to the inquiry:

"The importance of national market concentration cannot be overstated, as the non-majors have to survive and compete in the remaining space. Any further shrinkage of that space has major ramifications for the independent sector at both wholesale and retail levels."[11]

1.18 Furthermore, Associate Professor Frank Zumbo, competition law expert from the University of New South Wales, argues that:

"Risks to competition and consumers arise because mergers and acquisitions lead to a reduction in competitors and, in turn, lead to less competitive behaviour amongst the remaining players or to less incentive to do so or to innovate. This reduction in the intensity of competition is detrimental to consumers, as any "efficiencies" or to reduced costs achieved

[8] Dr Phillip Williams – Law Council of Australia, Proof Committee Hansard, 09 April 2010, pg 16

[9] Retail Traders Association of Western Australia, Submission 4, pg 1

[10] State Retailers Association of South Australia, Submission 8, pg 1

[11] National Association of Retail Grocers of Australia, Submission 7, pg 3

> by a merger are much less likely to be passed on to consumers and much more likely to be pocketed by the merged firm."[12]

The current test

1.19 The current substantial lessening of competition test under the Trade Practices Act does not appear to appropriately take into account the extensive market strength a corporation may hold, which enables it to dominate at a local market level, such as in the case of Woolworths.

1.20 Australia has some of the most highly concentrated markets in the world.[13] Supermarket giants, Woolworths and Coles, currently share 44 percent of the petrol market and 80 of the dry packaged grocery goods market, nationally.

This market power by its sheer volume enables Woolworths and Coles to operate and target competitors on a local level.

1.21 In these cases, the ACCC applies the substantial lessening of competition test to determine if a proposed merger or acquisition will have the effect of lessening competition in a market.

However, it can be argued that, with around 97 percent of proposed mergers and acquisitions being approved, it would seem that the threshold included in the test is far too onerous and high.

1.22 While a number of submissions and witnesses to the inquiry highlighted that the substantial lessening of competition test applied in Australia is in line with international competition law, it is important that this is held in context.

Contrary to other nations, Australia does not have powers, such as divestiture powers, which balance out this test and ensure fair competition in markets.

> "If we are going to talk about international comparisons, we are missing one very vital tool in the competition toolbox, and that is we do not have a general divestiture power."
>
> …
>
> "If we are going to talk about international comparisons, we need to be consistent. If the United States has a divestiture power we should have one, too. If the United Kingdom has a divestiture power, then we should have one, too."[14]

[12] Associate Professor Frank Zumbo, Submission 14, pg 2

[13] Associate Professor Frank Zumbo, Submission 14, pg 4

[14] Associate Professor Frank Zumbo, Proof Committee Hansard, pg 24

The case for replacing 'substantial' with 'material'

1.23 Under the proposed Richmond Amendment, a new test would be applied to prohibit any acquisition or merger that will have the effect, or is likely to have the effect, of ‘materially’ lessening competition in a market.

1.24 This would enable a more balanced test and a broader range of factors to be considered, such as local markets and national market power.

1.25 The material lessening of competition test would assess the reduction in consumer choice as a result of a merger or acquisition, whereas the substantial lessening of competition test effectively only focuses on pricing power.

1.26 Associate Professor Frank Zumbo states in his submission:

> "A material lessening of competition test would focus attention on whether or not the merger or acquisition would lead to a reduction in the number of efficient competitors in the marketplace and whether such a reduction would reduce the diversity or range of goods or services available to consumers. A material lessening of competition would also look to see whether the merger or acquisition would allow or facilitate “price coordination” behaviour between the market players remaining following the merger or acquisition."[15]

Creeping acquisitions

1.27 Throughout this inquiry, creeping acquisitions was an issue keenly debated. This Amendment seeks to limit creeping acquisitions, where large corporations are currently able to acquire assets in a piecemeal manner.

1.28 The Law Council of Australia shares this concern in its submission.

> …each individual acquisition may be unlikely to substantially lessen competition but there may nevertheless be a concern that, in aggregate, the combined effect of these acquisitions is to strengthen the acquirer's market position to the detriment of competition and consumers in the market.[16]

1.29 Indeed, while individually, these acquisitions may not be seen to substantially lessen competition, over time they may result in a larger market share and a reduction in competition.

1.30 In practice, a corporation under existing laws would ordinarily need to already hold substantial market power before it would be prevented from acquiring assets that, or would be likely to, further enhance that corporation’s market power.

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[15] Associate Professor Frank Zumbo, Submission 14, pg 9

[16] Law Council of Australia, Submission 2, pg 4

This effectively means that a corporation must have a monopoly, or near monopoly, of a market before it is prohibited under existing laws.

The most recent Federal Government proposals on creeping acquisitions will not change this and consequently, the gaps in the existing law will remain. The Richmond Amendment proposes to fill those gaps.

Conclusion

1.31 There is no question that competition is important and indeed crucial, and this sentiment is recognised by William Fares.

> **Mr Fares**—Competition is good for any business. It depends on what the competition is. When you have equal competition with someone at your level then it is good for everyone, but when we are talking about Woolworths or a big chain like that then that is not competition; it is really them against one person. It is not fair competition, not at all.[17]

1.32 The State Retailers Association of South Australia points out that this Amendment indicates a broader issue.

> While the amendment focuses on creeping acquisitions, this is but one part of a much bigger problem – market domination to the point where, in order to achieve the growth expected of them, Woolworths and Coles must, in fact, destroy the investment of others.[18]

During the hearing, Mr John Brownsea, Executive Director of the State Retailers Association of South Australia, further argued:

> **Mr Brownsea**—In the case of Woolworths, clearly the problem is their undoubted ability to be an absolute predator. I do not think the real problem is their coming next door and selling petrol, because the service station next door could probably live with that; but the rest of it they cannot live with. That is the problem. They front a fairly small community in behind them because the airport is further in and that is the end of their drawing area. It is a busy road that they are on and that limits their ability. They have been lucky up until now perhaps that competition in terms of petrol sales is a fair way away from them; and that is another reason probably for their survival. But they are one of an absolute declining number of privately owned service stations. And this is a planned process; there is no doubt about it. There are those who want to see these private individuals wiped out because, once you have the market, you have the ability to change the pricing structure. People will have to pay because they will have no choice, in actual fact.[19]

[17] William Fares, Proof Committee Hansard, 09 April 2010, pg 3
[18] State Retailers Association of South Australia, Submission 8, pg 2

[19] Mr John Brownsea – State Retailers Association of South Australia, Proof Committee Hansard, 09 April 2010, pg 45

1.33 The Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment) Bill 2009 seeks to 'level the playing field', and give small businesses, like the independent petrol station owned by the Fares, the protection they need from aggressive and arguably anti-competitive strategies of larger and more powerful corporations such as Woolworths.

1.34 Small businesses are essential to the competitive process and are critical to keeping big business honest, so that consumers get the best possible deal.

Recommendation 1

1.35 That the Bill be passed following minor amendments developed in consultation with stakeholders, in relation to concerns raised during the inquiry.

Nick Xenophon

Independent Senator for South Australia

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Spier Consulting
2	Law Council of Australia
3	Australian Community Children's Services
4	Retail Traders' Association of Western Australia Inc
5	Business Council of Australia
6	Ms Julie Clarke
7	National Association of Retail Grocers of Australia Pty Ltd
8	State Retailers Association of South Australia Inc.
9	RBB Economics
10	Shopping Centre Council of Australia
11	Australian Newsagents' Federation Ltd
12	Metcash Limited
13	Australian National Retailers Association
14	Professor Frank Zumbo
15	The Treasury

Additional Information Received

TABLED DOCUMENTS

- Document tabled by Mr William Fares at a public hearing in Adelaide on 9 April 2010: "Opening Statement"

APPENDIX 2

Public Hearing and Witnesses

ADELAIDE, Friday 9 April 2010

BROWNSEA, Mr John, Executive Director,
State Retailers Association of South Australia Inc.

DEITZ, Mr Andrew, Manager,
Infrastructure Competition and Consumer Division, Department of the Treasury

FARES, Mr William, Owner and Operator,
United Service Station, West Richmond

GRIMWADE, Mr Tim, Executive General Manager, Mergers and Acquisitions Group, Australian Competition and Consumer Commission

JONES, Dr David, Senior Adviser,
Infrastructure Competition and Consumer Division, Department of the Treasury

PAINE, Mr Bruce, Principal Adviser, Infrastructure Competition and Consumer Division, Markets Group, Department of the Treasury

RIDGEWAY, Mr Stephen, Deputy Chairman,
Trade Practices Committee, Business Law Section, Law Council of Australia

WILLIAMS, Dr Phillip, Member,
Trade Practices Committee, Business Law Section, Law Council of Australia

ZUMBO, Associate Professor Frank, Private capacity