

Treasury Submission to the Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment) Bill 2009

Introduction

The underlying policy intent of the *Trade Practices Act 1974* (TPA) is the enhancement of the welfare of all Australians through the promotion and preservation of competition. This policy intent is served by the promotion of competition, not the protection of particular competitors. Competitive markets are considered to be an important mechanism in driving efficiency and productivity gains; maximising the competitiveness of a market will tend to maximise efficiency and lead to the greatest enhancement in economic welfare.

Consistent with good economic regulatory practice, the merger provisions in section 50 of the TPA fulfil an important role in preserving the effectiveness of the competitive process by preventing mergers and acquisitions which substantially lessen competition (SLC) in a relevant market, while at the same time allowing businesses wishing to pursue mergers that do not lessen competition to do so free from government intervention. The effectiveness of the competitive process can be reduced through mergers and acquisitions which weaken competitive constraints or reduce the incentives for competitive rivalry within a market. The importance of the role of section 50 in its current form was emphasised in the Second Reading Speech accompanying the implementation of the SLC test in the *Trade Practices Legislation Amendment Act 1992*:

Merger control is an important element of any law aiming to preserve levels of competition. Mergers can lessen competition, potentially providing increased scope for price rises or collusive behaviour and lessening dynamic factors such as the rate of innovation. These possible detriments provide the rationale for government intervention in the area of mergers. On the other hand, mergers can be a valuable source of increased efficiency or other public benefits. Such possible benefits require that a line be drawn between those mergers which are likely to be beneficial and those which are likely to be detrimental to the community as a whole.

Is the current (SLC) merger test appropriate?

Treasury considers that the current legislation provides an appropriate framework for the assessment and consideration of mergers by the courts and the ACCC. Australia's legislative framework and SLC test, together with the enforcement practices of the ACCC, reflect current best practice and contribute to the efficient functioning of markets in Australia. Australia's SLC test for mergers is consistent with merger laws in many other OECD countries including the US, Canada, UK and New Zealand.

The Government's consultation process on possible changes to the TPA to creeping acquisitions has drawn out the community's views on Australia's SLC test. While some submissions argued that the test is unable to capture small-scale acquisitions that lead to an accumulation of market power over time (creeping acquisitions), it was almost universally held that while the SLC test is not perfect, it 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 and should not undertaken lightly.

There is always room to consider a review of the existing arrangements and current policy settings to ensure the best possible outcome for Australian consumers and businesses. It was for this reason that Treasury issued discussion papers on creeping acquisitions in September 2008 and June 2009, and the Australian Government is in the process of examining options to address this issue.

However, given the size of economic activity accounted for by merger activity in Australia and the importance of certainty, it is necessary to take a careful and balanced approach to considering any changes, especially since transitional costs will be involved in any changes. The value of merger and acquisition activity undertaken in Australia in 2009 is estimated at over US\$160 billion.

It is important to note that the SLC test is tighter than the dominance test that existed before 1993; the dominance test would likely have blocked many fewer mergers than the current SLC test, potentially leading to significant concentration and loss of competition in many Australian markets. Given that the SLC test reflects current international practice, any changes to make Australia's merger laws more restrictive should take into consideration the significant economic activity that may be at risk if a careful and balanced approach is not followed.

Further, it is critical that the text and Explanatory Memorandum for any proposed legislative change should be clear and unambiguous in explaining its policy intent, in order to provide the necessary guidance to the Courts and ACCC who must apply the law, and to businesses and legal practitioners who need to understand the implications of the law for their operations. This is particularly important for proposed changes to the TPA, whose provisions are frequently expressed in broad economic principles which must be interpreted by Courts. As noted below, Treasury is concerned that the intent and desired interpretation of this proposed change is not sufficiently clear, which is likely to lead to considerable uncertainty for business and consumers and may well lead to adverse unintended consequences.

How is the SLC test being applied by the ACCC in practice?

The Richmond Amendment Second Reading speech cited the high rate of merger approvals (approximately 97 per cent) as evidence that Australia's current merger test is too lenient and that the current system is failing. However, this assertion needs to be thoroughly tested.

In 2008-09, the ACCC considered 412 merger proposals, of which 10 were opposed and 402 were approved (including five where the ACCC's competition concerns were resolved with court enforceable undertakings). During 2009-10 to date¹, the ACCC has considered 185 merger proposals, of which nine were publicly opposed or confidential concerns were raised². In three other matters the ACCC's competition concerns were resolved with court enforceable undertakings, while five merger proposals were withdrawn prior to the ACCC completing its review, perhaps in part due to early issues raised by the ACCC.

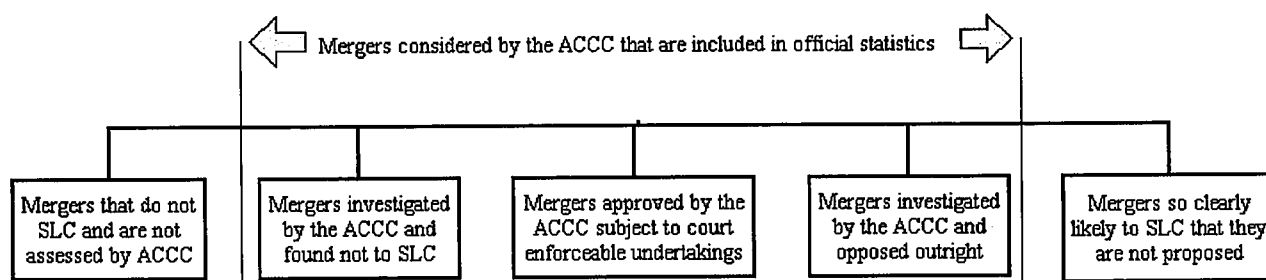
Mergers and possible mergers in Australia may be considered as a spectrum. At one end are non-contentious mergers which raise no competition issues. Many such matters are not even brought to the attention of the ACCC. A large proportion of the merger matters considered but not opposed by the ACCC are those referred to it by the Foreign Investment Review Board (FIRB) or the Australian Prudential Regulation Authority (APRA), or by the merger parties as a matter of courtesy. Most of these raise no competition concerns and do not require substantive review by the ACCC.

At the other end of the spectrum are mergers which would so clearly substantially lessen competition that they are not even proposed; such mergers are prevented by the SLC test even though they are not recorded as having been opposed by the ACCC. In between are (i) those proposed mergers not opposed because they are found after examination to be unlikely to substantially lessen competition, (ii) those which are found to be likely to substantially lessen competition and opposed outright, and (iii) those which are allowed to proceed subject to undertakings which addressed the ACCC's competition concerns. Therefore, in isolation, the

¹ For the period 1 July 2009 to 15 January 2010.

² A decision by the ACCC to raise competition concerns with a merger in a confidential review is essentially equivalent to a decision to oppose a merger in a public review.

percentage of mergers opposed and not opposed is not a good measure of the effectiveness or application of the merger test.



What is Australia's current merger law?

Overview of mergers and acquisitions provisions in the TPA

Section 50 of the TPA prohibits mergers or acquisitions that would have the effect, or likely effect, of substantially lessening competition (SLC) in an Australian market. This provides the ACCC with the legislative framework to consider and address potential competition concerns posed by mergers and acquisitions in Australia.

Under the TPA, prospective acquirers have three avenues available to have a proposed acquisition considered and addressed (these are discussed in the Appendix):

- assessment of the proposed acquisition on an informal basis by the ACCC; or
- an application for formal clearance of a proposed merger by the ACCC; or
- assessment by the Australian Competition Tribunal (the Tribunal) of an application for authorisation of a merger, using a net public benefits test.

As parties are not required by the TPA to notify the ACCC of a proposed acquisition, they have the option of proceeding with the transaction without seeking regulatory consideration. This would not prevent the ACCC from subsequently investigating the merger, including making public inquiries, using its formal information-gathering powers and taking enforcement action (remedies available are set out below).

The law and its administration

The ACCC and the courts have an important role in the interpretation and enforcement of the SLC test. The OECD (2002) makes the point that interpretation is key; the way a given merger test is interpreted and applied by the ACCC and the courts may be at least as important as the exact wording of the test.

Merger cases that have been considered by the courts and Public Competition Assessments published by the ACCC on key merger reviews provide guidance to prospective merger parties on the interpretation of section 50. The ACCC's 2008 Merger Guidelines (attached) further set out guidance on the general principles underpinning the ACCC's merger analysis. As a result of the guidance and precedent from these sources and the thousands of mergers that have been considered under the SLC test, the law and its administration are well established and understood in its present form, providing a degree of certainty to all parties. This level of certainty would take time to re-establish, and may be lost if the revised provision is unclear.

Australia's use of the SLC test is also consistent with international practice; the same test is used in many other OECD countries including the US, Canada, UK and New Zealand. In contrast, 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 (e.g. 'substantial'), and no other comparable jurisdiction has introduced a test based solely on the criteria of 'substantial share of a market'.

An increasing number of cross-border mergers are being assessed simultaneously by the ACCC and overseas competition agencies. If Australia's merger law were based on a test which is not found in any other jurisdiction, this may make it more likely that certain global mergers may be allowed in every jurisdiction other than Australia. While it is difficult to predict the consequences if this were to occur, one possibility that the firms involved may choose to proceed with the merger but cease to operate in Australia, potentially a worse competition outcome than if the merger proceeded.

While consistency with overseas laws should not be the primary consideration in the development of Australia's competition law, the advantages of this consistency should be considered as part of any assessment of proposed changes to the law.

Policy intent of the Richmond Amendment

The Explanatory Memorandum indicates that the purpose of the Bill is 'to strengthen Australia's anti-merger law and to address the issue of creeping acquisitions'. The Bill contains two key policy proposals.

- The first is intended to lower the threshold for prohibition of mergers and acquisitions by amending the test from a "substantial" to a "material" lessening of competition, in order to increase the number of acquisitions blocked on competition grounds.
 - The Second Reading speech states that the existing test is currently "too onerous and high" and has resulted in Australia having "some of the most highly concentrated markets in the world".
- The second aims to prevent creeping acquisitions³ by preventing corporations with a substantial share of a market from gaining greater share.

The Bill seeks to achieve these policy aims through two core amendments:

- the first would delete existing subsection 50(1) and insert a new prohibition that a corporation must not directly or indirectly acquire shares or assets if the acquisition would have the effect or likely effect of **materially** lessening competition in a market.⁴
- the second would insert a new test, that a corporation with a substantial share of a market must not directly or indirectly acquire certain shares or assets if the acquisition would have the effect or likely effect of lessening competition in a market.

³ Creeping acquisitions have traditionally been described as a situation where corporations make a series of small-scale acquisitions that do not individually substantially lessen competition in a market in breach of section 50, but collectively may have that effect over time.

⁴ The Explanatory Memorandum does not indicate whether subsection 50(2), which mirrors subsection 50(1) but in relation to persons (as opposed to corporations), would be amended, nor the Schedule version of section 50.

Possible effects of the Richmond Amendment

Proposal to replace 'substantially' with 'materially'

The Explanatory Memorandum states that the current test prohibiting acquisitions that "substantially" lessen competition is too high a threshold and has resulted in "a number of controversial mergers having recently been approved".⁵

The Second Reading speech cites the Woolworths/Danks, Caltex/Mobil, Westpac/St George and Commonwealth Bank/BankWest mergers as being of particular concern, without specifying the nature of the concern. It is noted that the ACCC subsequently opposed the proposed Caltex/Mobil merger, and that the proposed Woolworths acquisition of Danks was not opposed subject to Woolworths providing court enforceable undertakings to address the ACCC's competition concerns. As the responsible policy agency, it would not be appropriate for Treasury to comment on the ACCC's decisions in individual merger cases, but it is noted that the detailed reasons for the ACCC's findings in each matter are, or will be, made public on its website.

However, while these merger cases are used as justification for lowering the threshold for mergers, the Explanatory Memorandum does not demonstrate how the substitution of the word 'materially' for 'substantially' would have the effect of preventing similar mergers in the future, or how preventing such mergers would improve the welfare of Australians.

What is meant by 'substantially' in the current test?

The Explanatory Memorandum of the *Trade Practices Legislation Amendment Bill 1992*, which introduced the SLC test, relevantly stated that:

The term 'substantially lessening competition' is used widely through the [TPA]. It is here intended to mean an effect on competition which is real or of substance, not one which must be large or weighty.

In the debate on the Second Reading of *Trade Practices Legislation Amendment Bill 1992* the then Minister for Justice, Senator Tate, expanded on this, stating that:

...the Government intends that the test should apply to effects upon competition which are not merely discernible but which are *material* in a relative sense in the effect that they may have upon competition in the marketplace... (Hansard, 10 December 1992, p4776) [emphasis added]

The meaning of SLC has been considered by the courts, and the following observations are relevant:

The concept of "substantially lessening" competition is evaluative. There is only limited assistance to be derived from replacing the words with other phrases. In my opinion the phrase sets a standard for judicial intervention in respect of the classes of anti competitive conduct to which it applies. It requires, before that intervention can be invoked, that there be a purpose, effect or likely effect of the impugned conduct on competition which is substantial in the sense of meaningful or relevant to the competitive process.⁶

The relevant questions in this case are whether the effect of the arrangement was substantial in the sense of being meaningful or relevant to the competitive process.⁷

⁵ However, the Explanatory Memorandum does not provide further detail or evidence to support this claim.

⁶ *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) FCA 38 at [114].

⁷ *Rural Press Limited v Australian Competition and Consumer Commission* (2003) HCA 75 at [41].

The word ‘substantial’ in ‘substantial lessening of competition’ is another term requiring qualitative judgment which suggests that the use of analogues such as ‘large’ or ‘weighty’ would misdirect. It applies to ‘lessening’ which encompasses hindering or preventing competition (s 4G). As I said in *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41-752 there is only limited assistance to be gained by replacing the words used in the Act with other words. A description of the kind of judgment required by the word ‘substantially’, which appears recently to have been approved in the High Court, is that the effect of the acquisition be ‘meaningful or relevant to the competitive process’ – *Rural Press Ltd* at [41].⁸

The ACCC’s 2008 Merger Guidelines relevantly state that:

Not all mergers that lessen competition are prohibited by s. 50 of the Act; only those that lessen competition substantially are prohibited. The term ‘substantial’ has been variously interpreted as meaning real or of substance, not merely discernible but material in a relative sense and meaningful. 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.

The level at which an increase in market power is likely to become significant and sustainable will vary from merger to merger. For example, an increase in price that is very small in magnitude might also be significant. [2008 Merger Guidelines p. 11]

The concept of a ‘substantial’ lessening of competition has been part of section 50 since 1993, and is well established and understood by the Courts, ACCC, businesses and consumers as well as being an accepted test in major jurisdictions worldwide.

What is meant by ‘materially’?

The Explanatory Memorandum does not define ‘material’, but makes a broad reference to it being “a pronounced or noticeably adverse effect on competition”. In contrast to ‘substantial’, the term ‘material’ is not defined in the TPA, nor is there any established practice (case law) or use of the term in overseas competition law from which to derive its meaning in competition law in Australia.

A clear articulation of the law and its intended interpretation by the courts and the ACCC is important to understand its effects, its successful application in practice, and to minimise adverse unintended consequences.

There are a range of views on the meaning of ‘material’ – it has been equated with ‘substantial’,⁹ while others have defined it to mean ‘less than substantial’¹⁰. The OECD (2002) also makes the point that the SLC test is intended to capture any material, non-transitory creation or increase in market power.

As noted above, where ‘materially’ is interpreted as ‘a pronounced or noticeably adverse effect on competition’, and ‘substantially’ is interpreted as ‘meaningful and relevant to the competitive

⁸ *Australian Gas Light Company v Australian Competition and Consumer Commission* (2003) FCA 1525 at [351].

⁹ The New Zealand High Court decision relating to the proposed acquisition of the Warehouse by Woolworths discussed the meaning of the word ‘substantial’ (paras 127-129), finding that “‘material’ is a useful way of describing something that is... ‘real or of substance’ or ‘substantial’... in terms of the statutory test.”

¹⁰ For example, see (2004) *Government Response to Productivity Commission Report on the Review of the National Access Regime*, page 7.

process', it is not clear the extent to which this proposed amendment will substantively change the existing merger threshold.

However, the Explanatory Memorandum makes clear that the intention of the Richmond Amendment is to lower the threshold. Presumably, given the existing interpretation of SLC, this implies that the proponents would prefer a test which prevents mergers which have an effect less than 'meaningful and relevant to the competitive process'. However, where the boundary should alternatively be drawn has not been clearly articulated. Given this uncertainty, 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.

The importance of clearly articulating the law and its intended interpretation is underscored by the value of merger and acquisition activity in Australia. In 2008-09, the ACCC considered 412 merger proposals, of which ten were opposed outright and five were resolved through court enforceable undertakings.¹¹ During 2009-10 to date¹², the ACCC has considered 185 merger proposals, of which nine were publicly opposed or confidential concerns were raised¹³. The value of mergers and acquisitions undertaken in Australia in 2009 is estimated at \$US161.1 billion.¹⁴ There is a risk that this significant economic activity may be jeopardised if there is uncertainty about the way a new merger test is intended to operate.

In the absence of further clarification on precisely where the threshold for the prohibition of mergers should lie, it is difficult to assess the consequences of the proposed amendment, and in particular whether it strikes an appropriate balance between the achievement of positive benefits from merger activity while preventing competitive detriment.

Proposal to introduce a market share test

The Bill seeks to address creeping acquisitions by introducing a parallel prohibition against firms with a substantial share of a market from directly or indirectly merging with or acquiring shares or assets which would have the effect of lessening competition in that market.

The Bill therefore seeks to expand the range of mergers prohibited, by lowering the threshold through the removal of the requirement that the lessening or likely lessening of competition be substantial in order for an acquisition undertaken by a firm with a substantial market share to breach the TPA.

The role of market shares in merger analysis

The focus of the TPA is on ensuring that market conditions promote competition; it is therefore focused upon issues of market power. Introducing a test based on market share would represent a significant departure from the current approach.

¹¹ ACCC Annual Report 2008-09, page 45.

¹² For the period 1 July 2009 to 15 January 2010.

¹³ A decision by the ACCC to raise competition concerns with a merger in a confidential review is essentially equivalent to a decision to oppose a merger in a public review.

¹⁴ According to financial research firm Dealogic.

Furthermore, market shares are not determinative of market power; the proposed amendment does, however, appear to presume that market share can be equated with market power. The Explanatory Memorandum does not set out the framework supporting this presumption. For example, a firm can have a substantial degree of power in a market even though its market share in that market is quite low, and despite there being a number of other significant competitors in that market.¹⁵ The OECD also notes that a merger can produce anticompetitive effects even if the merged firm does not have the largest share of the market, or at least falls well short of the market share normally associated with single firm dominance.¹⁶ Conversely, firms with high market shares can hold little or no market power, and acquisition activity by those firms may lead to no competitive detriment.

Based on the intent described in the Explanatory Memorandum, the proposed amendment would interpret market share as being determinative – that is, it would make the assumption that there is something inherently anticompetitive about firms possessing substantial market share undertaking any acquisitions. As noted above, the two are not necessarily synonymous. The OECD observes that:

relying on structural considerations such as presumptions based on market shares risks moving merger review away from the important objective of enhancing economic efficiency and probably reducing legal certainty as well...market shares are generally not dispositive and...other relevant factors must also be considered.¹⁷

In the international context, market share thresholds are employed in screening processes supporting decisions by competition authorities on the need to further examine particular acquisitions under both the dominance and SLC tests. While it is a commonly held position that acquisitions occurring in more concentrated markets are more likely to raise competition concerns, such presumptions are rebuttable and do not substitute for analysis of individual transactions.

The ACCC and other competition agencies consider market concentration as just one part of their competition analysis in assessing the likely competition effects of a proposed merger, while also taking into account numerous other considerations such as the closeness of competition between the merger parties, competition from imports, substitutes, the threat of competitive entry, the presence of maverick firms, dynamic characteristics of the market, countervailing power of customers, and vertical integration of the merged firm. Focussing on market share to the exclusion of these other important factors may obscure the true competition effects of a merger.

Threshold for application – what represents a ‘substantial market share’?

It is also not clear how ‘substantial market share’ would be defined. For legal certainty, it would be necessary to make clear what the market share thresholds would be and how they would be applied. There is also the question of whether thresholds should vary across industries.

An arbitrary ‘bright line rule’ could be applied, beyond which a firm would be deemed to have a substantial market share. However, regardless of the level chosen, an arbitrary threshold would prohibit some mergers which would otherwise be considered beneficial or at least benign, unless it

¹⁵ For example, the Federal Court has previously imposed penalties for misuse of substantial market power where a corporation had only around 16-20 per cent of the share in the relevant market (*Australian Competition and Consumer Commission v Australian Safeway Stores Pty Limited* (No 4) [2006] FCA 21 (31 January 2006)).

¹⁶ OECD 2002: p8.

¹⁷ OECD 2002: pp26, 29.

was set sufficiently high so as to render this test redundant given the continued operation of the proposed replacement section 50(1) test.

- For example, if the threshold was set at 20%, many mergers which do not breach the current section 50 may be prohibited, and section 50(1) would likely be rendered largely irrelevant. Conversely, if the threshold was set at 80%, the provision would be unlikely to block many (if any) mergers that would not already be blocked under section 50(1).

The proposed amendment could effectively create a market share cap, preventing any takeovers or mergers by even modest-sized firms (depending on the local market definition), including acquisitions that are efficiency-enhancing and pro-competitive. This would contradict one of the key advantages of mergers: that they are important for the efficient functioning of the economy and can allow firms to achieve efficiencies, such as economies of scale or scope. A market share cap could adversely affect many small business owners seeking to sell their businesses, as they would be likely to have fewer potential acquirers, and could therefore face a reduced sale value for their businesses.

- Submissions to the Government's recent consultation on creeping acquisitions raised the issue of effective market share caps as a significant concern.¹⁸
- In addition, the 2003 Dawson Review of the competition provisions of the TPA argued against the adoption of market share caps as a response to creeping acquisitions concerns.¹⁹ The Dawson Review concluded that market share caps would stifle competition, protect the unsustainable position of inefficient competitors and could deny consumers access to the products or services offered by an efficient producer, particularly in rural markets.

The shortcomings of adopting a bright line approach may suggest that a more targeted approach might be more appropriate – that is, defining 'substantial market share' with reference to the competitive characteristics of a range of individual markets in the economy. However, determining market share thresholds for a range of industries or sectors on an *ex ante* basis for inclusion in legislation or subordinate legislative instruments would be impractical. Markets are not static. Thresholds and industry/sector boundaries would need to be continuously reviewed; the information-gathering and administrative challenges would likely be impossible to overcome.

- Any approach that relies on a 'bright line rule' for the meaning of substantial market share, whether in a law of general application, or on an industry-specific basis, would tend to move the legal argument from an assessment of the competition effects of the merger to defining exactly what the relevant market in question would be, as would-be acquirers would seek to demonstrate that the relevant markets were sufficiently broad as to mean they did not hold a 'substantial market share'.
- These economic and legal arguments, which are but one element of the existing SLC test and therefore fail to capture all of the relevant competition effects associated with a merger, can nevertheless be highly complex; it should not be assumed that focusing entirely on market share would make the task of demonstrating substantial market share straightforward.

¹⁸ Organisations such as the Law Council of Australia and the Business Council of Australia were particularly concerned about this possibility.

¹⁹ *Review of the Competition Provisions of the Trade Practices Act*, January 2003, page 67.

An alternative solution, adopting a case-by-case approach as matters arise, would inherently be recognising the importance of the competitive dynamics of the market – however, this is suggestive of an approach which in practice would tend to converge towards the approach used under the current SLC test.

'Lessening of competition' threshold

Noting the above issues regarding the proposed section 50(1A) test, where applied, the test would prohibit acquisitions which lessen competition in any market. It is noted that there appears to be a discrepancy between the Explanatory Memorandum, which seeks to prohibit firms with substantial market share from expanding that share through any acquisition without specifying that only acquisitions that lessen competition would be prohibited, and the Bill, which prohibits only those acquisitions by firms with substantial market share that breach a 'lessening of competition' test.

These two approaches are not necessarily synonymous, and there is a risk the Bill does not adequately reflect the policy intent described in the Explanatory Memorandum. Alternatively, if the Bill does reflect the policy intent described in the Explanatory Memorandum, then by prohibiting *any* acquisition by a firm with a substantial market share, the Bill has the effect of imposing a strict market share cap on such firms.

By adding this parallel test, the intent of the Richmond Amendment is to expand the scope of section 50 by preventing particular firms with substantial market shares from expanding those market shares to avoid detriment to competition and consumers.

Some acquisitions undertaken by firms that have substantial market share are already prohibited under the current SLC test. The proposed lowering of the threshold from 'substantial' to 'material' in section 50(1) would potentially mean that more mergers would be prohibited under section 50(1), which may reduce the relevance of the inclusion of the proposed section 50(1A).

The relationship between the proposed sections 50(1) and 50(1A) is not articulated. The extent to which the proposed section 50(1A) test would improve outcomes for consumers and preserve the competitive process is not explained. In addition, the extent to which the proposed amendment could prevent the realisation of efficiency gains and other public benefits is not addressed.

There also appears to be a discrepancy between the Explanatory Memorandum, which indicates that the prohibition would apply only to acquisitions which lessen competition in the same market in which the acquirer holds substantial market share, and the Bill, which may be interpreted to also prevent a firm with substantial market share in one market from making acquisitions in other markets in which it may not have substantial market share.

Summary

- The current merger law in Australia, based on the SLC test, has been in place since 1993. The law and its administration are well established and understood in its present form, providing a degree of certainty to all parties. It is consistent with the test used in comparable OECD countries, which is an increasingly relevant factor given the growing number of cross-jurisdictional mergers.
- The stated policy intent of the Richmond amendment is 'to strengthen Australia's anti-merger law and to address the issue of creeping acquisitions'. However, there is some uncertainty about what the impact of the proposed amendment would be, and the potential for unintended consequences.

- Any change to this law would have costs, including transitional costs, the loss of international consistency, and the need to re-establish certainty as to the application of the test. Before making any such change, consideration should be given to whether the outcome will in practice be an improvement on the present position.
- The experience of the SLC test in Australia is that some mergers are deterred by the SLC test without being 'rejected' by the ACCC or courts; these include mergers that are proposed but then withdrawn when parties anticipate a decision to oppose the merger, and those which are never brought forward for the same reason. This, combined with the large number of uncontentious mergers the ACCC reviews, mean that the percentage of mergers rejected by the ACCC may not be instructive as to the effectiveness or restrictiveness of the SLC test and its administration.
- It is always difficult to assess the costs and benefits of existing versus alternative tests, especially for the whole of the economy, given the need to measure the prevailing position against an unobservable counterfactual and the fact that factors other than mergers may be likely to have a more significant impact on observable variables such as price.
- These factors should be taken into account by the Committee in formulating its view on this Bill.

APPENDIX

International context

The proposed Richmond Amendment could have the effect of moving Australia out of line with international practice:

- 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 (e.g. many jurisdictions, including Australia, prohibit mergers likely to lead to a 'substantial' lessening of competition); and
- no other comparable jurisdiction has introduced a test based solely on the criteria of 'substantial share of a market'.

The jurisdiction with perhaps the most similar merger framework is the EU, which prohibits mergers that significantly impede effective competition (SIEC), in particular as a result of the creation or strengthening of a dominant position. However, the EU does not consider the creation or strengthening of a dominant position as a reason to prohibit a merger *per se*, acknowledging that since the adoption of the Merger Regulation in 1989, the notion of dominance has evolved such that merger assessment today is less reliant on the "rather blunt and imprecise market share test".²⁰ Under the new 2004 Merger Regulation there has been a shift away from a more structural approach to a more effects-based approach where the impact of the concentration on prices, output and other important features of the market (eg. innovation) are at the core of the assessment. In particular, the EU's Horizontal Merger Guidelines establish that market shares that do not exceed 25 per cent are unlikely to warrant competition concerns in a market with a post-merger HHI below 1000. However, the Guidelines spell out particular factors that could mitigate an initial finding of likely harm to competition such as countervailing buyer power, ease of market entry, failing firm defence and efficiencies.

The US merger regime applies a SLC test that is designed to prevent the creation or enhancement of market power roughly characterised as raising price above or further above competitive levels. The US Guidelines provide detail about how markets will be defined, market shares assigned and concentration estimated, as the prevailing level of concentration and changes in it are believed to be an important factor in determining whether a merger will tend to increase market power. Concentration is measured by the HHI, and 'safe harbours' (HHI thresholds) are used to determine whether a merger warrants investigation. A combined market share of the merging firms of at least 35 per cent also triggers investigation by the US competition authority. However, the Guidelines make clear that market share and concentration data are only a starting point for analysing a merger. The FTC also assesses the other market factors that retained competitive effects, as well as entry, efficiencies and failure. Even where a merger is likely to SLC, efficiency and failing firm defence arguments can be made. The bottom line is that while market share is one consideration, a range of other factors is also considered to determine whether a merger should proceed.

The OECD (2002) has found that, comparatively speaking, jurisdictions that use a SLC test have generally given a more market power based interpretation to their test and have generally relied less on market share presumptions. It is for these reasons that the SLC test is generally regarded as

²⁰ OECD 2002.

having a stronger grounding in economics than the dominance test, and being inherently more flexible.

Having said that, the OECD finds that there is no general consensus concerning the overall superiority of either the dominance or the SLC test, and the same is true regarding the advantages and disadvantages of both tests. It finds that what is important for legal certainty is that jurisdictions are transparent in their interpretation of the law, by ensuring that they publish detailed guidelines, describe their merger review decisions and possibly provide statutory criteria for their competition tests.²¹ However, in an international context, the growing number of cross-jurisdictional mergers makes it important that there is some degree of convergence between approaches to merger review.

²¹ OECD 2002: p46.

A comparison of the dominance and SLC tests

A 2002 OECD policy roundtable examined the substantive criteria for merger assessment, focusing on a comparison of the dominance test and the SLC test with respect to horizontal mergers. The key finding was that there is no general consensus on the overall superiority of either test, and the same is true regarding the supposed advantages and disadvantages of both tests. For example, while it was generally considered that in theory the SLC test can stop a larger set of anticompetitive mergers than the dominance test, it was not clear that many mergers fall into the 'gap'. However, both tests had some aspects that were broadly acknowledged as potential downsides. In particular:

- While the SLC test is able to block all mergers expected to produce unilateral effects, this is not as clear for the dominance test if a merger does not create or strengthen single-firm dominance.²²
- The dominance test is unlikely to capture coordinated effects unless dominance is defined to include collective dominance.²³
- The concepts of single and collective dominance can affect how abuse of dominance provisions are applied (and vice versa).²⁴
- Where there is no dominance pre-merger, the dominance test is unable to prevent mergers that increase market power but do not create a state of dominance; the SLC test is able to do so.
- Where there is dominance pre-merger, the dominance test may prevent anticompetitive mergers; the SLC test may not be able to do so.
- The dominance test may create legal uncertainty for businesses where authorities struggle to characterise unilateral effects as collective dominance effects.
- The SLC test is generally thought to have a stronger grounding in economics. However, the flexibility and comprehensiveness that this affords may make the SLC test more legally uncertain for businesses.

²² There is debate about whether the collective dominance concept can and should be extended to cover unilateral effects.

²³ The dominance test used in Australia prior to 1992 was defined more narrowly to only include single-firm dominance. This meant it was able to capture unilateral, but not coordinated, effects.

²⁴ For example, if a dominance jurisdiction sought to lower the dominance threshold to block certain anticompetitive mergers, it would need to consider how this will tend to widen the scope of its abuse of dominance prohibitions.

History of merger review in Australia

Australia's merger test has been the subject of considerable debate and revision over time, changing from an SLC test to a dominance test (1977) and back to a revised SLC test (1992). Key reasons for Australia's return to an SLC test in 1992 were that:

- a test focusing on the effect on competition in a market is more consistent with the policy underlying the *Trade Practices Act 1974*;
- it would have pro-competitive effects (covering a broader range of transactions, including those that raise issues of coordinated market power);
 - the dominance test had not improved efficiency and international competitiveness as anticipated.
- it would be more appropriate in an environment of deregulation; and
- it would create consistency between the merger test and the prohibition on anti-competitive agreements (section 45).

The SLC test considers a broad range of factors in determining whether competition is (or is likely to be) affected in a market as a result of a merger, whereas in Australia's case, the dominance test focused more on the market power of a single corporation (unilateral dominance). Unlike Australia's experience with the dominance test, many other jurisdictions that once used, or now use the dominance test, are able to target both unilateral and collective dominance.

While the SLC test's more 'flexible' approach to merger review could be viewed as creating less legal certainty, in Australia, steps such as the publication of guidelines and decisions have been taken to provide greater transparency and clarity with respect to merger review procedures, and it is now a well established and understood test.

Australia's current merger law

Informal clearance from the ACCC

Informal clearance is not a statutory regime under the TPA, but rather results in an assurance from the ACCC that it will not bring action for a breach of section 50 in relation to a particular merger (in other words, the ACCC considers that the merger does not substantially lessen competition in any market).

Should the applicant disagree with the ACCC's decision to oppose (i.e. not clear) a proposed transaction, it is not a legally reviewable 'decision', but rather the applicants could proceed with the merger and it would be incumbent on the ACCC to challenge it in court as a breach of section 50. The ACCC considered 412 merger matters under the informal clearance process in 2008-09 and it has considered 185 during the current financial year.²⁵

Formal clearance from the ACCC

Since 1 January 2007, parties have been able to seek formal clearance for an acquisition from the ACCC. Formal clearance is a statutory process that prevents any party from subsequently commencing legal action on the basis of an alleged contravention of section 50.

Unlike the informal clearance procedure, the formal regime has statutory timelines which requires the ACCC to make a determination within 40 days. In complex matters, this can be extended by 20 days with agreement from the applicant. If the ACCC does not provide clearance within the relevant timeframe, the ACCC is deemed to have made a decision not to clear the acquisition.

Formal clearances are reviewable by the Tribunal, unlike informal clearances. To date, no applications for formal clearance from the ACCC have been made.

Authorisation of acquisitions by the Australian Competition Tribunal

Firms may apply directly for an authorisation for an acquisition to the Tribunal if their application through the informal clearance process has been rejected (on the basis that it would contravene the SLC test in section 50) and they consider there are strong efficiency or public interest arguments to support the acquisition proceeding. The Tribunal then makes a final decision, having regard to the ACCC's views on the proposed transaction.

The Tribunal may grant authorisations for acquisitions when it is satisfied that the proposed acquisition is likely to result in such a benefit to the public that it should be allowed to occur. This involves a net public benefits assessment. This process has not been used since it was introduced, and under the TPA, may take up to 6 months to reach a conclusion.

Undertakings required by the ACCC

Where the ACCC considers that a proposed acquisition is likely to SLC, it may nonetheless allow the acquisition to proceed subject to undertakings by the merging parties. These are court enforceable commitments proffered by the merging parties to resolve competition concerns arising from mergers that may otherwise breach section 50 of the TPA.

²⁵ For the period 1 July 2009 to 15 January 2010.

Remedies available to the ACCC where section 50 is breached

Where an acquisition would, or would be likely, to lead to a SLC in an Australian market, the ACCC can seek to enforce its assessment in the Federal Court by:

- applying for a permanent injunction to restrain an anticompetitive acquisition; or
- pursuing pecuniary penalties against those involved in the acquisition.

If the ACCC is of the view that a completed acquisition has substantially lessened competition, it may also apply to the Federal Court for a divestiture order under section 81 within 3 years of the contravention. An order under section 81 can require a person to dispose of the shares or assets acquired in contravention of section 50, or it can take the form of a declaration that the acquisition is void (resulting in the vendor refunding the consideration for the acquisition).