CHAPTER 2: MERGERS

Background

The Act prohibits a merger that would substantially lessen competition. A merger may, however, be authorised on the basis that it would result in such a benefit to the public that it should be allowed to take place.

Section 50(1) provides:

> 'A corporation must not directly or indirectly: (a) acquire shares in the capital of a body corporate; or (b) acquire any asset of a person; if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.'

For the purposes of section 50, 'market' is defined to mean:

> 'a substantial market for goods or services in: (a) Australia; or (b) a State; or (c) a Territory; or (d) a region of Australia.'

The competition test laid down by section 50 is not unique to mergers. Other provisions in Part IV of the Act are concerned with conduct that would have the effect, or be likely to have the effect, of substantially lessening competition.

There is no specific statement of the objects of Part IV of the Act. However, the underlying assumption that competition promotes efficiency, which in turn enhances public welfare, is to be found in section 2 of the Act:

> 'The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.'

Section 50(3) provides a non-exhaustive list of matters that must be taken into account when determining whether a merger would have the effect, or be likely to have the effect, of substantially lessening competition in a market, as follows:

> '(a) the actual and potential level of import competition in the market;
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> (b) the height of barriers to entry to the market;
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> (c) the level of concentration in the market;

(d) the degree of countervailing power in the market;

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

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

(g) the dynamic characteristics 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.'

The ACCC's interpretation of these factors and the manner in which they are taken into account in the consideration of mergers is set out in merger guidelines issued by the ACCC.[1] The guidelines deal with the ACCC's approach to issues such as failing firms and efficiencies.

Mergers which are in breach of section 50 may give rise to proceedings for the enforcement of the Act. The proceedings may be brought in the Federal Court by the ACCC or, save for an application for an injunction, by a third party. The penalties which may be imposed include, in the case of a breach of section 50, an order for the divestiture of shares or assets acquired in the course of the merger.

The Act does not require the notification of a proposed merger. Apart from the option of seeking authorisation under section 88(9) of the Act, there are no formal means by which the parties proposing a merger may assure themselves that it will not be the subject of an action by the ACCC or a third party.

When the Act was introduced in 1974, it provided that those proposing a merger might request a decision from the Trade Practices Commission specifying whether the proposal was considered to be likely to have the effect of substantially lessening competition. This process was voluntary; there was no requirement that proposed mergers be notified. The provision was repealed in 1977, notwithstanding a recommendation of the Swanson Committee in favour of its retention. It was suggested to the Committee that the reason for the repeal was, in part at least, the administrative problem posed by a backlog

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1 ACCC 1999, *Merger Guidelines*.

of merger notifications. The change in 1977 occurred in the context of a concurrent amendment of the Act requiring mergers to be assessed against a market dominance test rather than the test of substantial lessening of competition. This approach, which was later reversed, meant that fewer merger proposals called for clearance.

In the absence of a statutory arrangement, a voluntary system has evolved under which the ACCC provides informal clearances for proposed mergers which it considers would not be in breach of section 50 because they would not have the effect, or likely effect, of substantially lessening competition. In clearing a merger in this way, the ACCC in effect undertakes not to challenge the merger in the Federal Court. The merger is, however, not protected from action by a third party.

Merger proposals are assessed on a case-by-case basis in accordance with the merger guidelines. The guidelines set out concentration thresholds below which it is considered unlikely that a merger would give rise to a substantial lessening of competition. Accordingly, the ACCC will generally only investigate a proposed merger where the merger will result in:

- the four, or fewer, largest firms having a combined market share of 75 per cent or more and the merged firm having a market share of at least 15 per cent; or

- the merged firm having a market share of 40 per cent or more.

There is a further indication of a safe harbour included in the guidelines: where imports have accounted for at least 10 per cent of sales in the relevant market for three years, a merger is unlikely to be opposed.

If the ACCC does not informally clear a proposed merger, the parties proposing the merger may abandon the proposal or proceed with it and risk action by the ACCC or a third party. They may also seek authorisation. However, proposals that do not initially meet the competition test under section 50 may still be cleared by the ACCC if the parties provide undertakings to the ACCC under section 87B of the Act which resolve concerns about the lessening of competition. The undertakings may relate to the structural or behavioural aspects of the proposal and are enforceable in the Federal Court.

Given the informal nature of the clearance system, the ACCC is not required to provide reasons for its decision to clear or oppose a merger. However, it does provide some reasons in some cases and also provides some information about particular mergers by way of media releases. It has a register of its merger

decisions on its website. The establishment of the public register followed a recommendation of the Griffiths Committee.

Under this informal process the majority of merger proposals are simply approved by the ACCC or approved subject to the provision of section 87B undertakings. For example, in the year 2001-02 the ACCC considered 237 proposals. More than 95 per cent of these were cleared. Of the nine proposals that the ACCC opposed, four proceeded after undertakings were provided to the ACCC. One proposal was submitted for authorisation.[2] The ACCC's statistics indicate that the proportion of mergers that raise competition issues has, over time, remained at around four to five per cent.

Under section 88(9) the ACCC may grant an authorisation for a merger which does not meet the requirements of section 50. In granting an authorisation, the ACCC is required by section 90(9) to be satisfied that the proposed merger would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

The Act does not define the term 'public benefit'. However, under section 90(9A), in determining what amounts to a benefit to the public for the purposes of section 90(9):

'(a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):

(i) a significant increase in the real value of exports;

(ii) a significant substitution of domestic products for imported goods; and

(b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.'

The Australian Competition Tribunal has determined that the term public benefit should be given its widest possible meaning. The ACCC's merger guidelines provide the following non-exhaustive list of matters that could constitute public benefits:

2 ACCC, *Annual Report 2001-02*, p. 72.

- economic development, for example in natural resources, through encouragement of exploration, research and capital investment;
- fostering business efficiency, especially where this results in improved international competitiveness;
- industrial rationalisation resulting in more efficient allocation of resources and in lower or contained unit production costs;
- expansion of employment or prevention of unemployment in efficient industries and employment growth in particular regions;
- industrial harmony;
- assistance to efficient small businesses, such as guidance on costing and pricing or marketing initiatives which promote competitiveness;
- improvement in the quality and safety of goods and services and expansion of consumer choice;
- supply of better information to consumers and businesses to permit informed choices in their dealings;
- promotion of equitable dealings in the market;
- promotion of industry cost savings resulting in contained or lower prices at all levels in the supply chain;
- development of import replacements;
- growth in export markets; and
- steps to protect the environment.

Under section 88(9) a formal application for authorisation must be made to the ACCC. A grant of authorisation by the ACCC may be reviewed by the Tribunal on the application of an interested party. Both the ACCC and the Tribunal are required to publish detailed reasons for their merger authorisation decisions.

The current system for the consideration of merger proposals is set out in Figure 1.

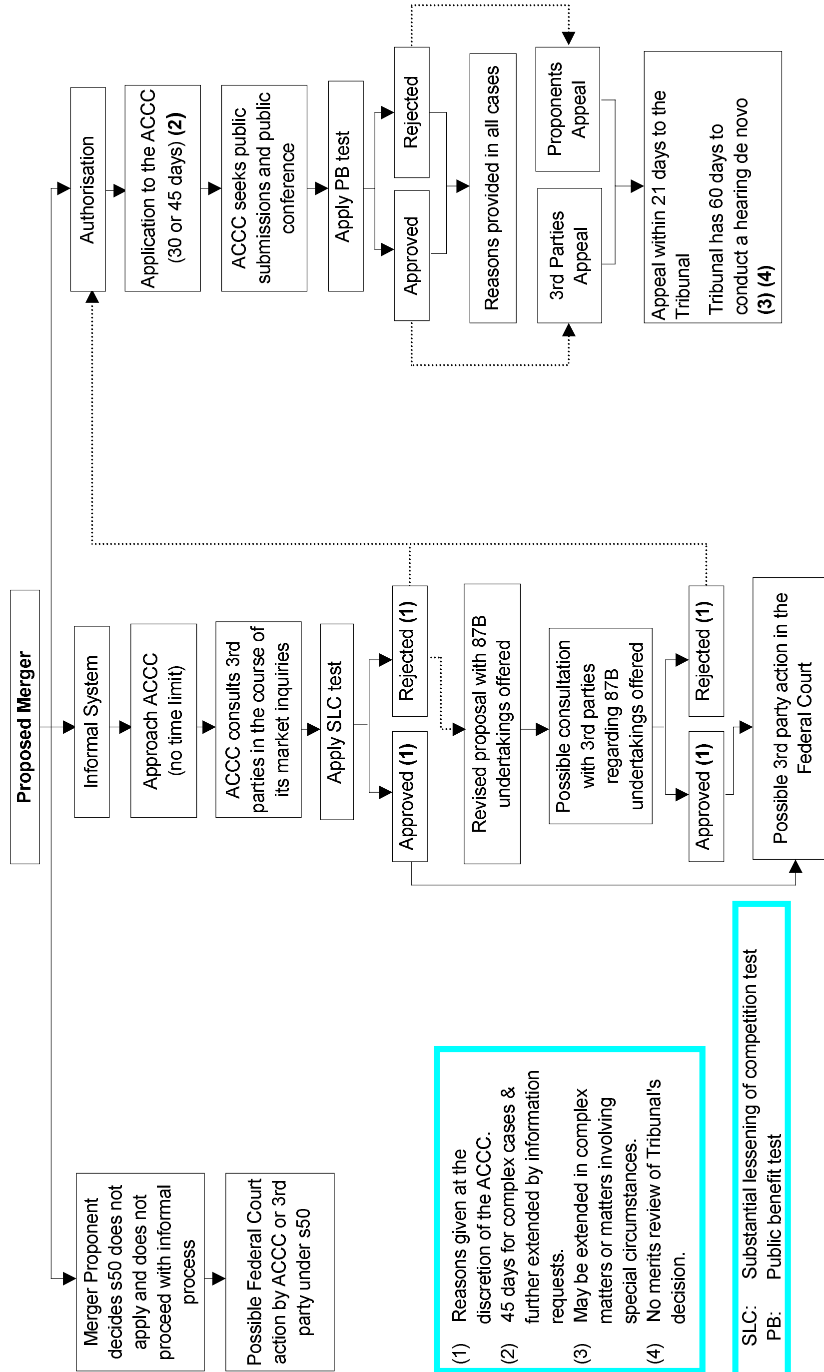
Figure 1: Current system
Proposed Merger
Merger Proponent decides s50 does not apply and does not proceed with informal process
Possible Federal Court action by ACCC or 3rd party under s50
Informal System
Approach ACCC (no time limit)
ACCC consults 3rd parties in the course of its market inquiries
Apply SLC test
Approved (1)
Rejected (1)
Revised proposal with 87B undertakings offered
Possible consultation with 3rd parties regarding 87B undertakings offered
Approved (1)
Rejected (1)
Possible 3rd party action in the Federal Court
Authorisation
Application to the ACCC (30 or 45 days) (2)
ACCC seeks public submissions and public conference
Apply PB test
Approved
Rejected
Reasons provided in all cases
3rd Parties Appeal
Proponents Appeal
Appeal within 21 days to the Tribunal
Tribunal has 60 days to conduct a hearing de novo (3) (4)
(1) Reasons given at the discretion of the ACCC.
(2) 45 days for complex cases & further extended by information requests.
(3) May be extended in complex matters or matters involving special circumstances.
(4) No merits review of Tribunal's decision.
SLC: Substantial lessening of competition test
PB: Public benefit test

Issues

Submissions made to the Committee indicate that there is widespread support for the current informal system for the clearance of mergers. The process is relatively speedy and inexpensive and is generally perceived to be effective. There are, nevertheless, some criticisms of the system. Because of the availability of the clearance process there are very few applications for authorisation. If the ACCC declines to clear a proposed merger, the matter is generally resolved by the negotiation of undertakings or the proposal is abandoned. There is a lack of transparency because there is a limited body of precedent to guide parties in relation to merger decisions. For example, there is uncertainty concerning the way in which the ACCC goes about defining the market in a particular case. Accountability is also seen to be deficient because the informal clearance process does not provide an effective review mechanism.

In some submissions it was suggested that the competition test under section 50 be broadened to include the consideration of gains in economic efficiency that may accompany a merger or the wider public benefits a merger may bring to the economy. The call for these changes reflects two concerns. First, there is dissatisfaction with the authorisation process (which does require the consideration of public benefits). Secondly, there is a desire to create a test that will allow greater weight to be given to economic efficiency in the clearance process than is currently possible under the substantial lessening of competition test.

Dissatisfaction with the authorisation process is largely attributed to concerns about the time which may be taken by the ACCC to reach a decision and the risk of third party intervention by way of appeal to the Tribunal. These factors are considered to render the authorisation process commercially unrealistic for many merger proposals, especially those involving publicly listed companies.

It was also said that section 87B undertakings may be extracted, even though the parties involved do not consider them to be appropriate, because undertakings are often considered to be a more commercially realistic option than seeking to advance a proposed merger through the authorisation process. Undertakings may be inappropriate, it is said, because they go beyond the scope of competition concerns in the relevant market or, if relevant to the market, go too far because they are not necessary for the purpose of ensuring that the merger does not substantially lessen competition.

Various changes to the system were suggested, which included:

- a requirement that the ACCC should be required to give detailed reasons for its informal merger clearance decisions;
- provision allowing the ACCC's decisions on merger proposals under the informal clearance process to be reviewed by a Competition Panel composed of business, consumer and government representatives or by the Tribunal;
- the introduction of a formal, but not compulsory, process for the consideration of merger proposals that could operate alongside the informal system;
- the inclusion of additional factors in section 50(3) such as international competitiveness and rural and regional issues;
- the consideration of public benefit by the ACCC as part of the informal clearance process; and
- provision of direct access to the Tribunal, with the Tribunal operating within strict time limits, for applications for the authorisation of mergers.

Some parties also proposed that there be a wider definition of the market for the purpose of considering merger proposals. A wider definition of the market would, it was said, enable more weight to be given to international competition. This would be consistent with the claim that to compete internationally Australian firms must be able to achieve greater scale, that is, become 'national champions'.

International context

European Union

In the European Union, a merger is prohibited if it would create or strengthen a dominant position (or collective dominance) which would significantly impede effective competition in the European Union.[3]

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3 *Council Regulation (EEC) No. 4064/89* of 21 December 1989 on the control of concentrations between undertakings (published in Official Journal L 395, 30 December 1989 as last amended Official Journal L40, 13 February 1998), Article 3.

A merger falls within the European Union's jurisdiction if it affects inter-Member State trade and its size exceeds a certain threshold turnover amount (EUR5 billion worldwide and at least EUR250 million within the European Union for at least two parties) or it significantly impacts on three or more Member States (with a lower turnover test). The regime is administered by the European Commission's Directorate-General for Competition.

Pre-merger notification is compulsory. The European Commission offers informal consultation to help parties determine whether their proposed transaction may fall within the European Union's jurisdiction. The European Commission initially reviews the proposed transaction within one month and may give a clearance. A decision is published but not necessarily with a market analysis. If the European Commission has serious concerns about competition, it will issue the parties with a Statement of Objections. It will then undertake an in-depth investigation over four months, resulting in a formal decision to grant a clearance or veto the merger. This time-frame may be suspended if the European Commission issues a formal request for further information. The European Commission publishes a decision, attaching an independent hearing officer's report advising on matters of procedural integrity. Confidential data is excluded.

Clearance by the European Commission provides immunity from challenges by national European Union authorities. No authorisation on public benefit grounds is available, although the European Commission may accept undertakings, both structural and behavioural, to remove anti-competitive concerns. Judicial review is available from the European Court of First Instance within six months and ultimately from the European Court of Justice.

The European Commission may order divestiture or any other action necessary to restore effective competition. It may also impose administrative fines for failure to notify a merger proposal or to comply with its decision on a proposal or a request for information. Private actions are only available for damages in national courts under national laws.

The Commissioner for Competition has proposed a series of reforms to improve the operation of the European Union's merger review processes.[4] They include clarifying the dominance test, improving the regulator's economic analysis capabilities, enhancing the involvement of consumer

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4 See the speech by the Competition Commissioner, Mr Mario Monti, *Merger Control in the European Union: A Radical Reform*, 7 November 2002. These proposals respond to the European Commission's *Green Paper on the Review of Council Regulation (EEC) No.4064/89*, 11 December 2001.

associations in investigations, expediting court hearings for merger appeals and allowing appeals on the basis that efficiencies can be shown to benefit consumers.

United States

In the United States, a merger will be prohibited if it would be likely to substantially lessen competition or tend to create a monopoly in any market.[5]

The regime is administered by the United States Federal Department of Justice (DoJ) and the United States Federal Trade Commission (FTC), an independent administrative body. Merger guidelines indicate that they will oppose a merger if it is 'likely to create or enhance market power or facilitate its exercise'. The DoJ and the FTC jointly administer a statutory notification procedure for proposed mergers over a US$50 million threshold.

Under this procedure, there is an initial 30 day waiting period, during which the parties may not complete the transaction. During this period, the FTC or DoJ may issue a 'second request' for information. This extends the investigation for 30 days after the parties provide the requested information. These time-frames are less for cash tenders. The FTC or DoJ then may approve the merger or seek a court order to veto it. Parties may negotiate undertakings, both behavioural and structural, to gain approval in the form of a consent order. No written reasons are provided to the parties for merger decisions.

The DoJ and FTC offer second request conferences with the merger parties shortly after issuing the second request. This allows the relevant agency to identify key issues and seek an agreed plan for the investigation. It is possible to make an internal appeal against complying with a second request notice from the FTC or DoJ, on the basis that it is unduly burdensome or the information has already been provided. Within three to nine days, this appeal will be handled by a senior official within the same agency who is not involved with the particular notification. However, in most complex merger cases, second requests are issued requiring extensive information.

5 Section 7 of the *Clayton Act 1914* (United States) and Section 2 of the *Sherman Act 1890* (United States).

If an agency obtains a district court injunction to prohibit a merger, the parties may appeal to the court of appeals for the circuit and ultimately petition the Supreme Court. There is no formal authorisation process available on public benefit grounds.

Through Court orders, the authorities may seek divestiture and/or fines of up to US$10 million for corporations and US$350,000 for individuals. Fines are also possible for failure to notify (US$11,000 per day). Alternative fines are available based on twice the pecuniary gain to the contravening party or twice the pecuniary loss to parties who have suffered loss. Private parties may seek these remedies if they can demonstrate that they would be injured by the anti-competitive aspect of the merger.

Jurisprudence regarding efficiencies continues to evolve, but the United States merger guidelines discuss efficiencies in some detail. These indicate that in most cases, proven efficiencies that benefit consumers immediately through lower prices and increased output will receive the most weight, but other efficiencies will also be considered to the extent they can be proved and can be shown ultimately to benefit consumers.[6]

Canada

In Canada, a merger is prohibited if it would be likely to substantially lessen competition in a relevant market.[7] There is a statutory 'efficiency' defence available if the efficiency gains from a merger outweigh its likely anti-competitive effects. The law on how this defence applies is still evolving with the key unresolved issue being whether to take into account narrow efficiency claims only or a broader concept of efficiency.[8]

The Competition Bureau administers a compulsory pre-merger notification system for mergers that exceed a certain turnover threshold (Can$400 million combined turnover or Can$35 million in assets in Canada). The Bureau decides whether to challenge a merger after 14 days of its notification or after 42 to 60 days if the notification involves a complex proposal. During these periods,

6 United States Department of Justice and Federal Trade Commission 1992 (as revised in 1997), *Horizontal Merger Guidelines*, footnote 37. See also William J Kolasky and Andrew R Dick, *The Merger Guidelines and the Integration of Efficiencies into Anti-trust Review of Horizontal Mergers*, pp. 30-32.

7 Section 96(1) of the *Competition Act 1985* (Canada).

8 See *Canada (Commissioner of Competition) v. Superior Propane Inc.* [2001] Vol. 3 Canada Federal Court Reports, p.185 (Court of Appeal).

the Bureau may request additional information which can extend an investigation up to five months.

Parties may seek an Advance Ruling Certificate from the Bureau stating there are no grounds to challenge the merger. No written reasons are provided to the parties for merger decisions. The Bureau is subject to a statutory requirement to observe confidentiality.[9]

There is no formal authorisation process available on public benefit grounds. Appeals from the Bureau's decision may be made to the Competition Tribunal, which is an independent quasi-judicial adjudicative body. A Tribunal decision may be reviewed on common law grounds. Statutory rights of appeal are available on questions of law and fact to the Federal Court, but appeals on questions of fact alone are at the discretion of the Court. Appeals from the Federal Court decisions are available to the Supreme Court of Canada.

Undertakings on both structural and behavioural matters may be given by way of a Competition Tribunal consent order. The Bureau may seek interim injunctions from the Tribunal on the basis that the merger would be irreversible. It may also seek final divestiture orders. Non-compliance may result in a fine up to Can$50,000. Damages may be sought only for failure to comply with a Tribunal order.

New Zealand

In New Zealand, a merger will be prohibited if it would be likely to substantially lessen competition in any market.[10]

The New Zealand Commerce Commission administers a voluntary pre-merger notification procedure. Within a statutory deadline of 10 days, the Commerce Commission publishes reasons for its merger decisions. Confidential information is excluded. Non-binding informal advice is also available. The Commerce Commission has a statutory deadline of 60 working days for authorisation decisions on public benefit grounds following a public consultation process.

Structural undertakings may be provided. Judicial review is available from New Zealand's High Court and ultimately its Court of Appeal. The Commerce Commission may issue cease and desist orders or seek injunctions or

9 Section 29 of the *Competition Act 1985* (Canada).
10 Section 47 of the *Commerce Act 1986* (New Zealand).

divestiture from the Court. Pecuniary penalties are available only by Court order (up to NZ$10 million for corporations and NZ$500,000 for individuals) and damages may be sought by private parties.

United Kingdom

The United Kingdom merger regime is in the process of being substantially revised. Under the *Enterprise Act 2002*, the Competition Commission will replace the Minister as the decision maker on mergers and the previous public interest test (including consideration of regional unemployment issues) will be replaced with a substantial lessening of competition test. The Minister will only be the decision maker on certain public interest mergers such as those in the media sector. Efficiency issues will be considered consistently with the substantial lessening of competition test at the assessment and remedy stage to the extent that they are relevant to the competition test, but in practice efficiency claims will need to be significant and established with some certainty. The *Enterprise Act 2002* directs the Office of Fair Trading not to refer a merger for further investigation to the Competition Commission if the Office of Fair Trading is satisfied that the merger would result in a 'relevant customer benefit' (for example, lower prices, higher quality, greater choice of goods) which would outweigh any substantial lessening of competition. This is similar to the consumer-focused United States approach to efficiency claims and accords with the European Union's test with regard to technical progression (for example, efficiency gains and innovation) only if it is to consumers' advantage and does not impede competition. The merger process will be transparent and include a public 'issues letter', 'remedies letter' and a final published report. The final report will be subject to judicial review.

The Competition Commission will also have the role of conducting market reviews to assess whether remedial action is required in particular sectors.

Analysis

The competition test

Section 50, together with other provisions of Part IV, focuses on the maintenance of competition in markets. However, as noted above, competition is not an end in itself. Section 50 serves the object of enhancing the welfare of Australians through increasing economic efficiency. The achievement of economic efficiency is an important goal because it is reflected in high productivity, which in turn is important in sustaining economic welfare. Maximising competition is the means to those ends.

As noted above, economic efficiency may take a number of forms. Productive efficiency is achieved where goods and services are produced at minimum cost. That is, optimum output is achieved through the best combination of labour, capital and technology. This is a major factor driving merger proposals because the most efficient combination of these resources will also mean increased profitability. Allocative efficiency is achieved when market processes allocate society's scarce resources to their most valuable use. For example, a vertical merger between two firms may result in lower prices for the same product, as one 'mark-up' is removed, and allow consumers to purchase more of another product. Dynamic efficiency is evident where the market is supplied with better quality goods and enhanced services due to technological innovation. For example, two merging firms may be able to pool their research and development expenditure to fund more effective product development.

In most circumstances maximising competition will maximise economic efficiency. Thus a test that prevents the substantial lessening of competition will generally be a good test for economic efficiency. However, there may be circumstances in which a merger will offer gains in efficiency but will also substantially lessen competition. This may occur when there are economies of scale, benefits or costs, that are external to the production process or when transaction costs are significant (see Box 1.1 in Chapter 1).

Section 50 does not address the situation that arises when a merger fails the competition test, but offers economic efficiencies with the potential to enhance overall welfare.[11] Such a merger may be authorised by the ACCC under section 90 if the efficiency gains represent public benefits that outweigh its effect on competition, but it cannot be approved at the clearance stage because the test to be applied there is the competition test under section 50.

The Committee considered the possibility of including an efficiency test in section 50. However, while economic efficiency is ultimately the more appropriate test for assessing the desirability or undesirabilty of a merger, there are important practical difficulties that arise.

An economic efficiency test would involve greater complexity than the current competition test. Such a test at the clearance stage would require more extensive economic analysis to be undertaken by the ACCC. This would require access to additional information and require more time to assess proposals. The ACCC might also need to consult more extensively with third parties than is necessary for the purpose of considering the likely effect of a

11 *Davids Holdings Pty Ltd v. Attorney-General* (1994) Vol. 121 Australian Law Reports, p. 241.

proposed merger on competition. These circumstances would be likely to extend considerably the time taken to complete the clearance process. At present, the process allows clearance to be given speedily to proposed mergers that the ACCC considers unlikely to substantially lessen competition.

The application of an efficiency test at the clearance stage would confer on the ACCC a significantly greater degree of discretion in deciding whether to clear or to oppose a merger proposal. Efficiency is already taken into account by the ACCC in applying the competition test laid down by section 50, but only to the extent that increases in efficiency contribute to the competitiveness of the market. The ACCC's merger guidelines state:

> 'If efficiencies are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality goods or services, the merger may not substantially lessen competition.
>
> While recognising that precise quantification of such efficiencies is not generally possible, the Commission will require strong and credible evidence that such efficiencies are likely to accrue and that the claimed benefits for competition are likely to follow.'[12]

If a broader efficiency test were to be introduced into section 50, there would need to be a more structured approach to its application than that offered by a clearance process. Such an approach is offered by the authorisation process and, in the course of that process, efficiencies may be considered in the context of public benefit. That is consistent with the scheme of the Act, which is primarily concerned with the promotion of competition. Accordingly, a merger that is likely to substantially lessen competition is treated as prima facie undesirable and prohibited. There is, however, provision for an application to be made for authorisation on the ground that the merger would be of such benefit to the public that it should be allowed to take place. Authorisation is by way of exception to the general prohibition and is only granted after a thorough consideration of the application. The application must be made public to enable interested parties to make submissions and the decision of the ACCC is subject to review by the Tribunal.

In a similar manner, the suggestion in some submissions that section 50(3) explicitly require the consideration of additional factors such as international competitiveness and rural and regional issues raises matters which may not be

12 ACCC 1999, *Merger Guidelines*, p. 60.

relevant to the competition test. Those matters are best dealt with in the authorisation process.

The public benefit test

In determining what amounts to a benefit to the public, the ACCC is required by section 90(9A) to regard as benefits (in addition to any other benefits) a significant increase in the real value of exports, a significant substitution of domestic products for imported goods and all other matters that relate to the international competitiveness of any Australian industry. The Act does not otherwise specify what constitutes public benefit and those words can, therefore, be construed broadly.

The merger guidelines note that in *QCMA*,[13] the Tribunal considered that the term should be given its widest possible meaning:

> '... anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.'

Hence the ACCC is not constrained by the authorisation process in considering public benefit and may look at such matters as economic efficiency, international competitiveness or the benefits to Australia of developing 'national champions'. This flexible approach, which allows mergers that substantially lessen competition to proceed because of the public benefit, is not to be found in other jurisdictions.

It was suggested to the Committee that the Act should be amended to specify various matters, such as the protection of small business or rural and regional issues, as matters which might be taken into account in determining what is in the public interest. Apart from the question of the relevance of such matters, there would be no real benefit to be gained from listing them. Any matters that might properly be listed can already be considered and listing them would risk their being given undue emphasis. The relevance of any particular matter and the weight to be attached to it is likely to vary according to the circumstances of each case. Any amendment of the Act which might confine the ACCC in its consideration of what is in the public benefit is, in the view of the Committee, to be avoided. In addition, the Committee notes that the United Kingdom has removed from its test for merger review the requirement that regional matters

13 *Re Queensland Co-operative Milling Association Ltd (1976)* Vol. 8 Australian Law Reports, p. 510.

be considered because it found that this consideration has not been a relevant factor in recent years.

Market definition

Section 4E provides that, unless a contrary intention appears, 'market' means a market in Australia and section 50(6) defines 'market' for the purposes of that section as a substantial market for goods or services in Australia, a State, a Territory or a region of Australia. Some submissions suggested that these definitions are too narrow, particularly for the purpose of considering the likely effect of a proposed merger on competition. In the case of many mergers, it was said that it is not possible to assess the likely effect on competition in Australia without regard to an international market, but to have regard to an international market is to recognise that the relevant market extends beyond Australia. However, the adoption of a wider geographic definition of a market would risk extending the relevant market beyond national borders altogether, making it more difficult to demonstrate that the merger of Australian companies would substantially lessen competition.

In practice, the statutory definitions do not create a particular problem. The merger guidelines state:

> 'Arguably, the Act does not require that the relevant market be defined as wholly within Australia, only that at least some part of it be in Australia. For practical purposes, there will generally be significant discontinuities in substitution between domestic and imported supply. In most cases the Commission will define the relevant market to be Australia or a part of Australia (including imports). However, in some circumstances it may be relevant to define the market as broader than Australia, for example, trans-Tasman, or even a world market.'[14]

The Committee regards the view taken by the ACCC as tenable and does not consider that there is any need for amendment of the statutory definitions of 'market'. Any further attempt to define that word for the purposes of the Act may confuse rather than clarify the present situation. The approach currently adopted by the ACCC allows it to have regard to foreign competition in a market. It is unlikely to oppose mergers where there is a significant and sustained level of competition from imports in the relevant market.

It was suggested that a wider definition of market would enable the ACCC, in determining the likely effect of a merger on competition, to consider whether

14 ACCC 1999, op. cit., p. 37.

the merger would enable the merged entity to compete more effectively in a global market. However, the issue raised there is whether the gains to the merged entity would warrant possible detriment to domestic consumers by the reduction of competition in the domestic market. The view was put that, in any event, vigorous competition which encourages efficiency and innovation is more important than scale for entry into international markets. These matters can, of course, be considered on an application for authorisation and in the Committee's view are best considered there. The benefits claimed for a proposed merger internationally can then be assessed alongside the impact of the proposal on domestic competition.

Merger processes

The strengths of the current informal clearance process stem from its informal nature, as do its weaknesses. The speed and efficiency of the process are generally regarded as being its greatest strengths. The voluntary nature of the process minimises the possibility of unduly delaying mergers that are unlikely to be in breach of section 50.

The weaknesses of the system are inherent in its informality. There can be no review of the ACCC's decision to refuse clearance and the ACCC cannot be required to give reasons for its decision. Where the ACCC forms the view that a merger would substantially lessen competition, the parties proposing the merger must either seek authorisation or proceed with the transaction and risk proceedings in court for penalties and divestiture. If neither option is attractive, as is likely, the parties must either withdraw their proposal or negotiate section 87B undertakings with the ACCC. The absence of an effective appeal mechanism may place the ACCC in a position to extract undertakings which go beyond competition concerns arising from a merger. The absence of reasons for the ACCC's decisions hinders the development of a body of precedent to assist in the making of consistent and predictable determinations.

The proposals for change to the informal merger process would require it to be formalised to some extent with the risk that there would be a reduction in speed and efficiency.

The Committee is not attracted to the concept of a Competition Panel based on the Takeovers Panel as a mechanism for reviewing the ACCC's decisions on merger proposals. A Competition Panel could not be the trade practices equivalent of the Takeovers Panel. The Takeovers Panel is a body involved in dispute resolution. It considers differences that arise between commercial parties. Its decisions are quite different from those of the ACCC concerning the likely effect of a merger on competition in a market, including detailed legal

and economic analyses. Moreover, it would be inappropriate for such a panel to make decisions with respect to clearance, otherwise leaving the ACCC with the responsibility of administering the Act, including responsibility for the commencement of proceedings for the enforcement of its provisions. A Competition Panel based on the Takeovers Panel would not be better equipped to decide questions of competition than the ACCC.

A new system

At a minimum, the informal process would be improved, and the potential for regulatory error reduced, if the ACCC were required (taking care to protect any confidentiality) to provide adequate reasons for its decisions when requested to do so by the parties and in cases where it rejected a merger or accepted undertakings. The provision of reasons in these instances would allow a better understanding of the ACCC's decisions and reduce uncertainty about the way in which the process operates. Confining the informal obligation to give reasons to these three instances would minimise the administrative burden on the ACCC and should not contribute to any significant delay in the process.

It is desirable, in principle, that decisions of a body such as the ACCC be subject to review on the merits. However, it is not apparent how the current informal decisions taken by the ACCC could be subjected to review without recognising the process in the Act and hence formalising it. The introduction of a review would also require the ACCC to provide more comprehensive reasons for its decisions than it currently does.

The replacement of the informal process with a compulsory, formal notification of mergers would greatly increase the regulatory burden both on corporations proposing to merge and on the ACCC.

The creation of a voluntary formal process that would operate in parallel with the existing informal system would seem to offer the best of both worlds. Such a system would be similar in concept to that which has been established in New Zealand (see Box 2.1). An optional formal system would not remove the advantages of the current system, but would provide parties proposing a merger with an optional process whereby they might gain a greater understanding of the reasons for the decision and be given the opportunity to have the Tribunal review an unfavourable decision. The availability of a review would increase the accountability of the ACCC for its decisions. The decisions of the Tribunal on review would provide guidance to the ACCC in its approach to clearance, both formal and informal, upon questions such as the definition of the relevant market or the lessening of competition.

Box 2.1: The New Zealand voluntary notification system

Parties wishing to merge in New Zealand may make application for formal approval of their proposal to the Commerce Commission but are not obliged to do so.

The Commerce Commission will then publish the application on its website and has ten working days to grant or decline clearance for the proposal. The time taken to assess the merger can only be extended with the agreement of the merging parties.

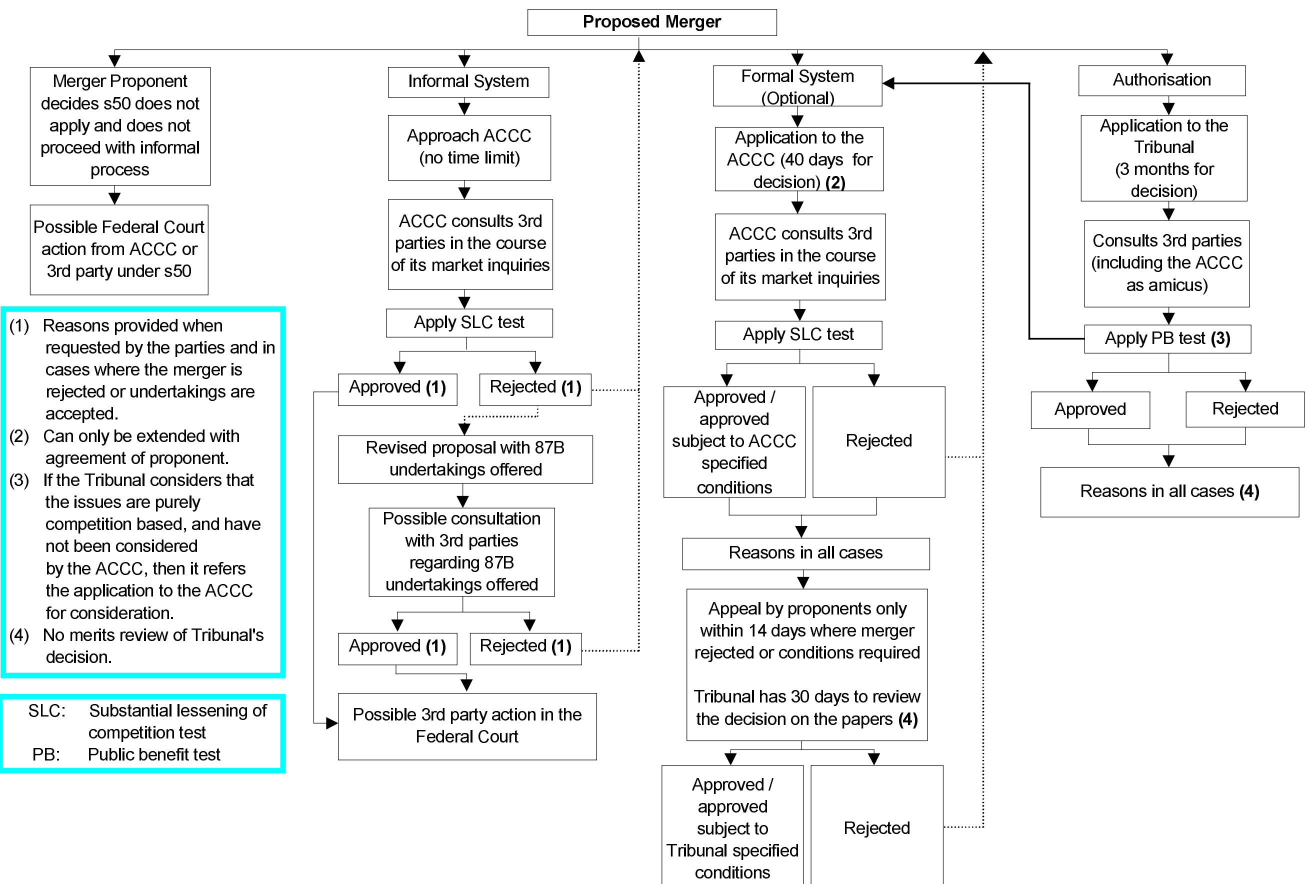
The Commerce Commission is required to publish reasons for its decisions. All confidential information is excluded from its published reasons.

Appeals on the merits of the Commerce Commission's merger determinations may be made to the New Zealand High Court and, on further questions of law, to the New Zealand Court of Appeals.

The Committee is not suggesting that there should be any requirement in the Act that all merger proposals be notified to the ACCC or be formally considered. The benefits of the informal clearance process should be retained so that most merger proposals would continue to be dealt with as expeditiously as they are now.

A scheme that would allow the parties proposing a merger the option of making a formal application for clearance to the ACCC upon the basis that the merger would not have the effect, or be likely to have the effect, of substantially lessening competition, is outlined in Figure 2. The requirements for making an application (which could be set out in revised merger guidelines) would need to be specified with a view to ensuring that the information provided to the ACCC was sufficient to enable a sound assessment to be made. The information required should not, however, be excessive. The ACCC should be required to assess the proposal within a statutory time-frame of 40 days (which should provide sufficient time for consultation with third parties). If a decision were not provided within 40 days, the clearance of the merger would be deemed to have been refused. The 40 day limit would be capable of extension only at the request of the applicant. The ACCC would be required to provide appropriate reasons for its decisions.

Figure 2: Proposed system



Under this system, formal clearance of a proposed merger would provide statutory immunity from proceedings by any party for breach of section 50. The applicant would only have statutory immunity while complying with any conditions specified by the ACCC as a condition of the approval of the merger. It would be the responsibility of the ACCC to monitor these conditions. Unsuccessful applicants would have the option of seeking a review of the ACCC's decision by the Tribunal within 14 days of the decision.

The Committee proposes that third parties not be permitted to seek a review of a clearance given by the ACCC. Currently, the ACCC is the only party able to apply for an injunction to prevent a merger from proceeding. An optional formal clearance would, therefore, offer a means of removing the element of uncertainty currently surrounding merger proposals. However, it is desirable that the views of third parties be considered and the ACCC should be required to engage in appropriate consultation with them.

The Committee also proposes that the review by the Tribunal of the ACCC's formal decisions to refuse clearance should be limited to a consideration of the material before the ACCC and should not be by way of a hearing de novo. This should reduce the workload that would otherwise be imposed on the Tribunal. It would also mean that applicants could not engage in forum shopping by reserving relevant information for consideration by the Tribunal rather than the ACCC. The Tribunal should be given 30 days to review a decision. As with the ACCC, the Tribunal would be able to grant a clearance, reject a clearance or grant a clearance subject to conditions.

Authorisation

Authorisation may be sought for proposed mergers that may be prohibited by section 50 of the Act because they would have the effect, or be likely to have the effect, of substantially lessening competition. However, it was generally accepted in submissions made to the Committee that authorisation is not, as a matter of commercial reality, a viable option in the case of most merger proposals. It was said to be too time consuming and the outcome too uncertain with the decision being open to review at the instance of interested third parties. In fact, authorisation is rarely sought. Only five authorisations of mergers have been sought from the ACCC since 1995.

The ACCC's consideration of an application for the authorisation of a proposed merger may be unavoidably lengthy in many cases because of the matters the ACCC must consider. It has 30 days to consider an application for authorisation. This time may be extended to 45 days for complex matters. It

may also be extended if the ACCC requests information from the applicant or with the agreement of the applicant.

Third parties may seek a review of the ACCC's decision. An authorisation by the ACCC may be reviewed by the Tribunal on the application of an interested party within 21 days of the date of the determination. An application for review may be made by any party that can demonstrate a sufficient interest in the matter, including competitors of the parties proposing the merger. The Tribunal has 60 days to conduct its review of a determination. The review consists of a hearing de novo and new material not before the ACCC may be relied upon. The duration of the review may be extended by the Tribunal if it considers that the matter cannot be dealt with properly within the 60 days because of the complexity of the matter or by reason of other special circumstances.

The Committee considers that the merger authorisation process would be improved if the parties applying for authorisation were required to make their application directly to the Tribunal. This procedure is also illustrated in Figure 2.

Direct application to the Tribunal would greatly reduce the time taken in considering an application for authorisation. It would also meet the perception of some parties that the ACCC is not able to look afresh at authorisation applications based upon public benefit because of its previous consideration of the effect, or likely effect, of the proposed merger on competition. There would be no review on the merits of the Tribunal's decision. Whilst that may be regarded as a shortcoming, it would be offset by the saving in time and the achievement of greater certainty of outcome.

The time taken by the authorisation process would be reduced because direct application would eliminate the current requirement that the ACCC first consider the proposal for up to 45 days and the attendant risk that the matter still could not proceed because of a review initiated by a third party. Under the proposed arrangement, authorisation would become a one step process since there would be no decision upon the public benefit of a proposed merger by the ACCC and no appeal from the Tribunal's decision other than by way of judicial review.

The Committee's proposal has significant implications for the Tribunal. A procedure would need to be devised which would enable interested third parties to present their views. The ACCC should appear to assist the Tribunal. In this capacity it would have the responsibility of using its resources to prepare and place before the Tribunal the material necessary for it to evaluate

the application and make a decision. In this way the quasi-judicial role of the Tribunal would be preserved. The resources of the Tribunal would need to be increased substantially to enable it to perform its new function.

The Tribunal should have the power to remit an application for consideration by the ACCC if it were of the view that the application required a decision solely on competition questions posed by section 50 rather than a decision concerning public benefit under section 90(9) and those questions had not previously been considered by the ACCC.

It would be reasonable to expect that, under the scheme envisaged by the Committee, the Tribunal could reach a decision on an application for authorisation within three months. The Committee believes that a time limit of this order should be imposed to make the process more predictable and more acceptable from a commercial viewpoint. It may not suit everyone, but authorisation is inevitably a public and relatively lengthy process. This is necessary, given that authorisation involves transactions that will substantially lessen competition. The public interest requires them to be thoroughly investigated.

Creeping acquisitions

Some submissions referred to creeping acquisitions in the context of mergers. The term 'creeping acquisitions' generally refers to the acquisition of a number of individual assets or businesses over time that may have a cumulative effect upon the market share of a competitor. However, no individual acquisition by itself would necessarily constitute a substantial lessening of competition in the relevant market so as to fall within the prohibition imposed by section 50.

For example, it was said that the acquisition of retail grocery outlets has allowed the major supermarket chains to increase their concentration in the market without being in breach of section 50. Measures of concentration based on the scanned grocery market, which covers only 35 per cent to 40 per cent of all products sold by the main chains,[15] indicate that the market share of the two major chains has increased from 57 per cent in 1996 to 68 per cent in 2002.[16] However, the scanned grocery measure ignores several important lines in which the two main chains compete with other retailers, such as fresh meat, fruit and vegetables, delicatessen and fresh bakery products. Broader measures

15 Woolworths Limited, Submission No. 171, p. 9.

16 ACNielsen 1999 and 2002, *Grocery Report*.

that include those items indicate that the major chains have around 50 per cent of all sales in 2002, having increased from 39 per cent in 1996.

A number of submissions proposed measures to deal with the issue of creeping acquisitions.

One proposal was that when a corporation reached a certain market share, further acquisitions would be prohibited or 'capped'. Concern was expressed that to adopt this proposal would be to stifle competition and protect the unsustainable position of inefficient competitors. This view is confirmed by the findings of the Baird Committee and the submissions of the ACCC that a market cap in the retail sector would be unworkable and would effectively regulate the consumer.[17] In a regional market the operation of a cap could deny consumers access to the products or services offered by an efficient producer.

Another proposal envisaged the declaration of highly concentrated industries by the Government. Once an industry was declared, acquisitions taking place within the industry would be required to be notified to the ACCC and examined by it. This would be consistent with the current arrangements under the Retail Grocery Code of Conduct. This proposal would affect all mergers in an industry since it would require notification by all participants, regardless of their market share. It is not clear what the focus of the ACCC's examination would be. In the absence of a cap on market share, compulsory notification might result in larger participants establishing new facilities rather than acquiring existing businesses, possibly to the detriment of those wanting to sell their businesses.

A further proposal was that section 50(3) should be amended to include a reference to creeping acquisitions as a relevant concern. However, the Committee is of the view that section 50 in its present form is adequate to enable the ACCC to consider creeping acquisitions in so far as they raise questions of competition. They are referred to in the merger guidelines. Nothing before the Committee suggests that the ACCC is not presently aware of acquisitions that raise competition concerns under section 50.

More importantly, while a genuine competitive environment exists, the preservation of the number of competitors in a market is more a matter for industry policy than for competition policy. A concentrated market may be highly competitive. Whilst there may be a desire to preserve the number of

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17 Report by the Joint Select Committee on the Retailing Sector (the Baird Committee) 1999, *Fair Market or Market Failure? A Review of Australia's retailing sector,* Parliament of the Commonwealth of Australia, Canberra.

competitors in a competitive market, it will ordinarily be for policy reasons other than the promotion of competition. Part IV of the Act is concerned with the promotion of competition rather than industry policy.

Conclusions

- There is widespread support for the current informal system for the clearance of mergers. The process is relatively speedy and inexpensive and is generally perceived to be effective.

- Section 50, together with other provisions of Part IV, focuses on the maintenance of competition in markets. However, competition is not an end in itself. Section 50 serves the object of enhancing the welfare of Australians through increasing economic efficiency. The achievement of economic efficiency is an important goal because it is reflected in high productivity which in turn is important in sustaining economic welfare.

- Whilst the introduction of an economic efficiency test into section 50 may reflect ultimate concerns, practical difficulties make such a change undesirable. It would add complexity leading to the likelihood of a longer and more formal process and require the exercise of greater discretion by the ACCC. It is more appropriately considered n the authorisation process.

- There would be no benefit to be gained from listing additional specific items for consideration in the competition test as part of section 50(3).

- There would be no benefit to be gained from listing additional specific items for consideration in the application of the public benefit test. Any matters that might properly be listed can already be considered and listing them would risk their being given undue emphasis.

- Further definition of the 'market' for the purposes of the Act may confuse rather than clarify the ACCC's present, satisfactory interpretation. Issues concerning a merged entity's capacity to compete more effectively in global markets are best dealt with in the authorisation process rather than by changing the definition of 'market'.

- The speed and efficiency of the current informal clearance process are generally regarded as being its greatest strengths. The weaknesses of the system are evident in the absence of an effective mechanism for review and the absence of reasons for the ACCC's decisions, which hinders the development of a body of precedent to assist in the making of consistent and predictable determinations.

- At a minimum, the informal process would be improved, and the potential for regulatory error reduced, if the ACCC were required (taking care to protect any confidentiality) to provide adequate reasons for its decisions when requested to do so by the parties and in cases where it rejected a merger or accepted undertakings.

- The creation of a voluntary formal mergers approval process that would operate in parallel with the existing informal system would retain the advantages of the current system but overcome some of its disadvantages.

- An optional formal system could include a time limit for the assessment of merger applications against the current competition test applied by the ACCC. It could also be designed to reduce delay and uncertainty by providing for the Tribunal to consider appeals within 30 days on the basis of the information considered previously by the ACCC, and by providing that there be no third party appeal rights in relation to the merits of the application.

- Dissatisfaction with the merger authorisation process is largely attributed to concerns about the time which may be taken by the ACCC to reach a decision and the risk of third party intervention by way of appeal to the Tribunal. These factors are considered to render the authorisation process commercially unrealistic for many merger proposals, especially those involving publicly listed companies.

- The merger authorisation process could be made more attractive to business by making it more timely and reducing uncertainty. Applications for merger authorisation, which rely on public benefit grounds under section 90(9) of the Act rather than the section 50 test, could be made directly to the Tribunal rather than the ACCC, and could be resolved by the Tribunal within three months. Third party interests could be considered as part of the Tribunal's assessment rather than through an appeal process. This change will have significant implications for Tribunal processes and its resourcing. It would be desirable that the ACCC should appear in order to assist the Tribunal.

Recommendations

2.1 The ACCC should provide adequate reasons for its decisions (taking care to protect any confidentiality) in the informal clearance process when requested to do so by the parties and in cases where it has rejected a merger or accepted undertakings.

2.2 A voluntary formal clearance process should be introduced, parallel to the existing informal clearance process, in relation to merger applications requiring consideration under section 50. This formal clearance process should have the following features:

2.2.1 on application by the parties, the ACCC might grant a binding clearance upon the basis that a proposed merger would not contravene section 50. The applicant would have immunity from proceedings by any party while complying with any conditions specified by the ACCC as a condition of the approval of the merger. The ACCC would be required to monitor compliance with these conditions;

2.2.2 the information required for such an application, which could be set out in revisions to the ACCC's Merger Guidelines, should not be onerous but should be sufficient for the ACCC to make a reasoned assessment;

2.2.3 the Act should require the ACCC to make a decision within 40 days which would allow the ACCC to consult with third parties. If a decision were not provided within 40 days, the clearance of the merger should be deemed to be refused. The 40 day limit should be capable of extension only at the request of the applicant; and

2.2.4 only the applicants should be granted a right of review by the Tribunal on the merits of the ACCC's decision. The application for review should be made within 14 days of the ACCC's decision. The hearing before the Tribunal should be on the material before the ACCC and not a hearing de novo. Decisions of the Tribunal should be made within 30 days. The Tribunal should be able to grant or reject a clearance or grant a clearance subject to conditions.

2.3 Applications for the authorisation of mergers should be made directly to the Tribunal. This process should have the following features:

2.3.1 applications should be considered within a statutory time limit of three months;

2.3.2 there should be no review on the merits of the Tribunal's decision; and

2.3.3 the Tribunal should have the power to remit an application for consideration by the ACCC if it were of the view that the application required a decision solely on competition issues under section 50 rather than a decision concerning public benefit and the ACCC had yet to formally examine the matter.