Submission to the Committee of Inquiry

Inquiry into the competition provisions of the *Trade Practices Act 1974*, and their administration

1 Introduction

1.1 SFE Corporation Limited ("**SFE**") and its subsidiary companies provide exchange-traded and over-the-counter ("**OTC"**) financial services to institutions throughout the Asia-Pacific region and globally. On the SFE Trading side of the business these subsidiaries include the Sydney Futures Exchange and the New Zealand Futures and Options Exchange. On the SFE Clearing side the subsidiaries include SFE Clearing Corporation and Austraclear.

1.2 Fully electronic and with 24-hour trading capability, SFE offers the financial market community trading products for investment and risk management, disseminates real-time and historical trading market data and provides centralised clearing, settlement and depository services for both derivative and cash products. SFE Corporation Limited listed on the Australian Stock Exchange on 16 April 2002.

1.3 Over the past 15 years, SFE has had direct experience of the application of the competition and authorisation provisions of the Trade Practices Act 1974 ("**TPA**") both as an applicant for authorisation of its contractual arrangements with users of its markets and clearing and settlement facilities and as a party to proposed mergers and acquisitions. This submission is provided to the Committee of Inquiry ("**Committee**") by SFE in order to raise a number of issues that have become apparent to SFE from this experience.

1.4 This submission:

(a) outlines the relevant merger and authorisation provisions in the TPA;

(b) reviews the main criticisms of Australian merger law and procedure;

(c) reviews the response of the Australian Competition and Consumer Commission ("**ACCC**") to those criticisms;

(d) analyses the limitations of the Australian merger review system by reference to SFE's specific experiences and its more general research;

(e) proposes some general principles and objectives that should be embodied in the TPA; and

(f) proposes some changes that may promote a more efficient and effective system for merger review.

1.5 The key conclusions of this submission are that:

(a) there is insufficient basis for changing the "substantial lessening of competition" test in section 50 of the TPA;

(b) the focus, instead, should be on finding the best way of ensuring that countervailing public interest issues – including those relating to efficiencies – are considered and given proper weight.

1.6 The focus of this submission is upon general issues in the public interest. However, it would be unrealistic for SFE to present its views without some acknowledgment of its particular experiences.

1.7 In 1999, the ACCC determined that a merger of ASX and SFE would involve a substantial lessening of competition. The prospect of such a merger has been the subject of considerable public discussion, much of it critical of the ACCC's analysis[1]. SFE's analysis draws upon its experience of this transaction and notes that the ACCC's analysis was restricted to issues relating to competition. That analysis did not proceed to consider issues and arguments relevant to the public interest. Ultimately, the proposed merger did not proceed and has not been attempted again.

1.8 In many other areas of public administration, the parties to a potential transaction are likely to know before embarking on the transaction, how the relevant law is likely to be interpreted and applied by those with power to block the transaction. In SFE's view the parties and the public are entitled to a degree of clarity as to how the law will be interpreted and applied.

1.9 No such clarity exists as to how the ACCC might view the public interest arguments in the authorisation process. This is because there have been few authorisation applications in relation to mergers. Indeed,, there is some apprehension that sound public interest arguments might not prevail whilst ever the issues are analysed sequentially rather than simultaneously. By the time the ACCC has formed a fixed view that a transaction would involve a substantial lessening of competition, without reference to efficiency or broader national interest issues, the chances of such arguments being found sufficiently persuasive to alter that fixed view is likely to be reduced.

1.10 To the extent that uncertainty as to the umpire's likely decision is merely a function of there being finely balanced factors to be taken into account, there is no scope for criticism of the current law or procedures.

1.11 However, to the extent that corporate actions are being inhibited by uncertainty as to whether transactions that are widely regarded as being in the public interest would be allowed to proceed, then process changes require exploration.

1.12 If the ACCC were to be called upon to authorise a transaction involving SFE, SFE anticipates that the parties would point to the enhanced capacity to compete internationally that would be delivered by any merger that led to significant elimination of duplicated infrastructure.

1.13 In any such merger SFE anticipates that the ACCC may have concerns about encouraging the domestic market power of a merged entity if it could be established that the merger would lead to that company deriving monopoly rents from the domestic market in order to cross-subsidise its international competitiveness. Whilst this may be the result in some industries, SFE believes that it will not be the result in every case and, in particular in a merger of the kind contemplated in paragraph 1.12 above. The issue which this example raises for the current inquiry is whether the current processes mitigate against the ACCC being able to remain sufficiently open minded as to the possibility of monopoly rents being derived from the domestic market will not be the inevitable result in *every* industry.

1.14 The fact that mergers or acquisitions involving companies providing utility or network services may produce efficiencies which outweigh anti-competitive effects is something which could be expected to have been reflected in various published decisions of the

---

[1] Fair or Foul? Trade Practices Law under Review. *Australian Financial Review* 27 February 2002.

ACCC across different industries by now if efficiency considerations had been given proper weight when the competition effects were being considered. These types of issues and arguments may have been raised and considered, but because the Australian informal merger clearance process has failed to produce a significant line of published decisions and because the TPA does not require the ACCC to consider efficiencies in any detailed manner, Australian business does not know whether they have been raised, the extent of the consideration given to them and the reasons for their acceptance or rejection

1.15 Similarly, one could reasonably expect to have seen published and detailed reasons involving the following arguments but the likely weight the ACCC may give to these arguments remains unclear, despite the detailed Merger Guidelines:

(a) in instances where the price of services supplied is less relevant to customers than the cost savings they can make themselves from not having to use different network services, an efficiency analysis may be compelling[2];

(b) where industry-specific legislation exists enabling Government to influence who controls the companies operating markets of national significance, the public interest may involve enabling Australian companies to achieve the scale to compete globally. In SFE's case, inability to achieve scale through domestic merger would be a reason for it to partner with or become owned by foreign interests, yet Government policy may regard this as contrary to the national interest[3];

(c) where a company has become the focal point for activity whose value extends beyond the goods or services it provides to encompass national interest issues, it may be in the public interest to allow this value to be preserved by authorising a particular merger[4];

(d) it is in the public interest for Australian stakeholders to be able to exert significant influence on the future shape of the markets in which they operate[5].

1.16 A more comprehensive commentary on each of these propositions, as they apply to the world of financial exchanges and clearing/settlement systems is set out in the endnotes in Annexure 2 to this submission.

2 Outline of Merger Law and Procedure in Australia

2.1 Section 50 of the TPA prohibits share or asset acquisitions which have the effect or likely effect of substantially lessening competition.

2.2 The ACCC has responsibility for enforcing section 50. In June 1999 it published detailed Merger Guidelines which it applies to its analyses of proposed mergers. Under section 80,

---

[2] see endnote 1

[3] see endnote 2

[4] see endnote 3

[5] see endnote 4

the ACCC is the only party that can commence proceedings for injunctions to restrain a merger.

2.3 Section 50 applies to all mergers. However, the ACCC has adopted a policy where it generally will only investigate a merger where:

(a) the post-merger market share of the four (or fewer) largest firms is greater than 75%, and the merged firm will have at least 15% of the market share; or

(b) the merged firm will have at least 40% of the market share.

2.4 Whilst there is no compulsory pre-acquisition notification requirement, the ACCC encourages parties to informally advise and consult with the ACCC about a proposed merger or acquisition. There is no provision for this process in the TPA and the ACCC's "decision" under this process has no legal status. This process is referred to in this submission as the "informal clearance" process.

2.5 The ACCC also has a formal power to authorise mergers, pursuant to section 88 of the TPA. This is discussed in paragraph 2.11 below.

2.6 The ACCC's Merger Guidelines recommend that the parties should provide a written submission to the ACCC which includes:

(a) background details of the parties;

(b) information on the structure of the market, including relevant information about the other market participants;

(c) the commercial rationale for the merger; and

(d) an analysis of the proposed acquisition, addressing:

(i) the actual and potential level of the import competition in the market;

(ii) the height of barriers to entry in the market;

(iii) the level of concentration in the market;

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

(v) the likelihood that the acquisition would enable the acquirer to significantly and sustainably increase prices or profit margins;

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

(vii) the dynamic characteristics of the market, including growth, innovation and product differentiation;

(viii) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and

(ix) the nature and extent of vertical integration in the market.

2.7 In SFE's experience the following occurs:

- ACCC staff will generally conduct market inquiries if the parties to the proposed transaction have not requested confidentiality.

- Face-to-face discussions with the parties (and competitors) often form part of the process. Upon lodgement of an informal clearance submission, there is no publicly stated and formal procedure.

- A staff paper is then produced for the Mergers Review Committee or a full meeting of the ACCC, setting out the information, analysing the proposed merger and providing a recommendation. SFE understands that most matters are considered by the Mergers Review Committee, with the more complex matters being considered by a full meeting of the ACCC. As the process is controlled by the ACCC there is a degree of uncertainty as to what will occur, for the parties involved.

2.8 Uncertainty also extends to the timing in which a decision will be reached by the ACCC on an informal clearance application. Whilst there is no requirement for the ACCC to consider the merger within a certain timeframe, in the majority of cases, the ACCC states that it is able to provide a response within two to four weeks. However, in more complex cases, the ACCC states that it may take six to twelve weeks to reach a decision.

2.9 On a confidential informal clearance application the ACCC may:

(a) request the parties not to proceed if it considers that the acquisition would substantially lessen competition;

(b) inform the parties that it has some concerns but will not oppose the acquisition prior to making market inquiries;

(c) in the absence of market inquiries, will not express an opinion but will not oppose the acquisition at that point in time.

Parties are notified of the ACCC's decision in writing.

2.10 On a non-confidential clearance application the ACCC may:

(a) inform the parties that it has no objections to the request the parties not to proceed (at all, or in its current form) if it considers that the acquisition would substantially lessen competition;

(b) request the parties to modify the proposal to address any anti-competitive consequences either informally or formally by way of s87B undertakings;

(c) suggest the parties seek formal authorisation.

Parties will be notified in writing. The ACCC may also issue a press release.

2.11 There is no avenue to appeal the ACCC's decision on an informal clearance application. While some reasons are usually provided for the decision, there is no legislative requirement for reasoning and evidence to be stated or made public. The volume and detail of any such information is at the discretion of the ACCC.

2.12 If the parties threaten to proceed with a merger despite ACCC opposition, the ACCC may bring injunctive proceedings in the Federal Court.

2.13 The ACCC also administers a separate authorisation process for mergers pursuant to section 88. Sections 88(9) and 90(9) provide that the ACCC may grant an authorisation for a merger. The effect of an authorisation is that whilst the authorisation in force, the section 50 prohibition does not apply. The authorisation process is not often used. There have been 12 applications lodged in respect of mergers since 1993.

2.14 On an authorisation application:

(a) The ACCC must be satisfied in all the circumstances that the acquisition would result, or would be likely to result in such a benefit to the public that the acquisition should be allowed to take place[6]. In particular, the ACCC must regard a significant increase in the real value of exports and a significant substitution of domestic products for imported goods as benefits to the public and must take into account any other matters that relate to the international competitiveness of the industry in Australia[7].

(b) The ACCC must provide a determination within 30 days, after which the authorisation will be deemed to be granted[8], unless the ACCC notifies the applicant, that due to the complexity of the issues involved, the time for consideration will be extended to 45 days[9].

(c) Authorisation determinations by the ACCC can be appealed to the Australian Competition Tribunal[10].

2.15 Summaries of the merger review processes in the USA, Europe and New Zealand are contained in Annexure 2 to this submission.

3 Review of Criticisms of Merger Law and Procedure

3.1 A range of concerns have been raised in relation to the current administration and enforcement of the TPA and specifically, the merger review procedure[11]: SFE does not support all of the criticisms that have been raised but notes that the following concerns have received the most prominent support:

(a) The powers and reach of the TPA and the ACCC have grown markedly in recent years, but this growth in power has not been matched by necessary improvements in accountability.

(b) The size of the Australian economy creates an acute dilemma for competition policy. There is a need to ensure the TPA balances vigorous domestic competition

---

[6] TPA: s90(9)

[7] TPA: s90(9A)

[8] TPA: s90(11)

[9] TPA: s90(11A)

[10] TPA: s101

[11] "TPA Review Critical to Prosperity: BCA", Media Release, Business Council of Australia, 9 May 2002.

with the growing imperative for Australian companies to achieve the scale and efficiencies necessary to compete internationally.

(c) The current merger review policy is cumbersome and commercially unrealistic.

(d) Arguments in relation to scale and efficiencies are not dealt with early enough in the merger review process.

3.2 It has been suggested that ACCC decisions on mergers should be appellable to a special mergers review panel of the Australian Competition Tribunal.

3.3 The criticism of the current merger law's role in stifling the ability of Australian firms to compete on a global market is based on a concept of 'critical mass'. It is also sometimes called the 'national champions' argument.

3.4 These arguments are predicated on the advantages of scale for efficiency. They are also predicated on the advantages of 'weight'. A government or company unable to participate in 'blocs' (for countries) or merge (for companies) will become marginalised in a globalised world[12].

3.5 Critics see three ways in which the merger laws and processes can be 'loosened' to overcome the negative impact of the laws on Australian firms' ability to merge and compete internationally:

(a) revert to the supposedly more permissive 'dominance' test;

(b) alter the processes so that the benefits of scale and efficiencies are given greater weight and can be taken into account at earlier stage; and

(c) alter the criteria for merger clearance.

3.6 The Institute of Public Affairs[13], in its call for a return to a test of "dominance" for mergers instead of the current "substantial lessening of competition", relies on an efficiencies of scale argument. It submits that the tougher test has led the ACCC to inappropriately oppose mergers or to place costly conditions on them, thereby denying Australian industry and Australian consumers the benefits of lower costs.

3.7 This has lead to a push for the ACCC to determine the issue of scale and efficiency at an earlier stage. At the moment, these arguments are most likely to be deferred and only become important when assessing the public benefit of a merger under an authorisation application. There is also support for changing the existing criteria, e.g. to increase the threshold under which mergers would not be investigated, and to require the ACCC to give more weight to global factors in examining local mergers.

3.8 Maurice Newman, Chairman of the Australian Stock Exchange argues that there must be debate about the trade-off between merged Australian firms dominating an open local market and the risk of anti-competitive behaviour. He suggests that many of the mergers brought before the ACCC wouldn't even register on the radar screens of similar

---

[12] Maurice Newman, "Growing Global Giants", *CEDA Bulletin*, October 2001, p 35-37.

[13] Richard Salmons, "Restrain the Watchdog, Says Free-Market Body", *The Age*, 22 June 2002.

competition regulators in countries where Australian firms need to compete, and that a size threshold should be introduced so that only the very largest mergers would be examined. He also moots a change in the criteria such that the focus is more on global competitiveness than domestic domination[14].

3.9 Currently, the scale and efficiency benefits of a merger tend to be considered at authorisation stage. The authorisation application usually only occurs after the ACCC has rejected a merger on competition grounds.

3.10 The Wattyl-Taubmans merger is often raised as an example of the inefficiency of the merger review process in Australia. The merger went to the ACCC for informal clearance but was found to be anti-competitive, went back to the ACCC for authorisation on public benefit grounds, and was refused, and then went to the Australian Competition Tribunal on appeal. This process took months. At the time it was suggested that parties should be able to apply directly to the Australian Competition Tribunal for a merger authorisation.

4 Review of the ACCC Responses to Industry Criticisms

4.1 In response to criticisms of inconsistency in the ACCC's decisions, ACCC Chairman, Allan Fels argues that when a series of close mergers are considered, it is not difficult to mount a case of apparent inconsistency, but that the decisions need to be placed in context. Even if there are similar structural circumstances, the ACCC may decide differently depending on the weight accorded to particular factors. Fels argues that the fact that the ACCC has to make some 'on-balance' decisions about a few borderline mergers doesn't mean that there is not a general consistency in the consideration of the vast majority of mergers before it.[15]

4.2 In relation to the criticisms of the ACCC's anti-merger bias, Fels maintains that the ACCC is not anti-merger: it only opposes those mergers which lead to a substantial lessening of competition, and very few have this effect. He quotes the small number of mergers actually opposed: in 1997-98 the ACCC reviewed 176 mergers and opposed 5. In 1998-1999, 185 mergers were reviewed and 7 opposed and in 1999-2000, 208 were reviewed and 4 opposed.[16]

4.3 The ACCC's response to the argument that the merger provisions prevent domestic firms from developing the 'critical mass' to compete internationally is three-fold:

(a) There is no evidence that, simply by merging with a competitor, a company's ability to compete internationally is enhanced. Size is not a prerequisite to export success.[17]

---

[14] Maurice Newman, *ibid.*

[15] Allan Fels, "The *Trade Practices Act* After 25 Years: Mergers and the Role of the ACCC" (1999-2000) 4(2) *Deakin Law Review* 39, at 44.

[16] Allan Fels, "Mergers & Market Power", Australia-Israel Chamber of Commerce Speech, Sydney, 15 March 2001.

[17] Ross Jones, "Retaining a Competitive Environment", Australian Insurance Institute 2000 National Conference – Future Business Intelligence, Brisbane, 27 July 2000. See also, Fels, "Mergers & Market Power", *ibid.*, who gives examples of several smaller to medium sized firms who are successful exporters.

(b) Arguably, national rivalry rather than national dominance is more likely to generate innovative and efficient firms more able to compete in international markets[18]. Fels also argues that Australian companies could not become internationally competitive without a competitive domestic market to keep down input costs. He asks "Would Australia's big companies be internationally competitive if they had to secure their raw materials, such as coal and petrol, from a monopoly supplier?"[19]

(c) There is a reasonable fear that a national champion may use its domestic market dominance to increase the domestic price to import parity and subsidise its export price[20]. Lin Enright, spokesperson for the ACCC said, "We don't believe Australian consumers should be subsidising the adventures of companies overseas"[21].

4.4 The ACCC argues that in any event, the merger provisions are not an obstacle to firms achieving a size that will bring the economies of scale necessary for international competitiveness[22].

4.5 On one hand, the ACCC maintains that it considers the impact of global factors on competition in Australian markets. It has not rejected a merger where imports have maintained, over the medium term, a market share in excess of ten percent, even in circumstances where the merger has led to a domestic production monopoly[23].

4.6 On the other, the real key is that the merger must bring public benefits. An anti-competitive merger can be authorised if it compensates with public benefits, which can include a significant increase in the real value of exports and significant import substitution.[24]

4.7 The ACCC argues that compared with other competition agencies, the time it takes to deal with merger applications is relatively short. Fels points out that the ACCC normally deals with most merger applications within a period of four weeks with some complex applications taking around six to eight weeks, and authorisations considered within 30 days, or 45 days if the merger is complex. He concedes that there is a right of appeal to the Australian Competition Tribunal for authorisations, which effectively has no time limit.[25] Any comparison between jurisdictions and time taken should be carefully approached because, as this submission proposes, a process that provides a formal and appellable

---

[18] Jones, *ibid.*

[19] Fels, "Mergers & Market Power", *ibid.*

[20] Jones, *ibid.*

[21] "Corporate Australia vs ACCC – One Fels Swoop", Samantha Maiden, *Adelaide Advertiser*, 14 May 2002.

[22] Fels, "Mergers & Market Power", *ibid.*

[23] Jones, *ibid.*

[24] Fels, "Mergers & Market Power", *ibid.*

[25] Fels, "Mergers & Market Power", *ibid.*

decision may carry more value and certainty than an 'informal clearance'. On this view, the ACCC compares apples with oranges when it claims 'world best practice'[26].

4.8 The Merger Guidelines and informal consultation process itself, the ACCC argues, gives rise to administrative efficiencies and a comparatively light regulatory burden[27].

4.9 However, Fels has conceded that there is room for changes to the merger-approval process and guidelines[28].

5 Limitations of Australian Merger Procedure

5.1 SFE considers that the majority of criticism directed towards Australian merger law and procedure under the TPA does not derive from any actual or perceived inadequacy or unsuitability of the "substantial lessening of competition" test in section 50 of the TPA. Where criticism is directed towards the substantial lessening of competition test, SFE does not consider that the arguments behind such a change are convincing.

5.2 SFE doubts whether a change from the substantial lessening of competition to the dominance test would make any discernible difference to the likely outcome of the majority of mergers proposed. Most relevantly, such a proposed change would be unlikely to make any difference to the likely outcome of an ACCC review of a merger in which the national champions argument was advanced.

5.3 The national champions argument in its purest form is apparently based upon the assumption that a merger relying upon the argument would substantially lessen competition in an Australian market but that the merger would deliver benefits to Australian consumers by assisting the merged firm to compete internationally.

5.4 Leaving aside the evidentiary basis or cogency of such an argument, SFE regards this argument as essentially going to public interest rather than competition. For this reason, the proposed change to a dominance test would be ineffective in promoting a national champions argument.

5.5 On the basis of SFE's prior experience with the informal clearance and authorisation procedures, difficulties with the current procedures may be distilled into the following categories:

(a) lack of a decision with legal weight and status;

(b) lack of transparency;

(c) lack of consistency/accountability;

(d) apprehension of a pre-determined outcome.

---

[26] Tim Holland, IIR Trade Practices Conference, Sydney 18 June 2002.

[27] Fels, "Mergers & Market Power", *ibid;* Jones*, ibid.*

[28] "Crunch Time For Fels' Critics", *Australian Financial Review*,27 May 2002.

Legal Status

5.6 Whilst, in the Merger Guidelines, the ACCC encourages parties to approach it, on an informal basis, as soon as there is a real likelihood that a proposed acquisition may proceed, there is no legislative requirement that such a process occur. The result of seeking informal clearance has no legal status and is not subject to appeal. However, the practical effect of an ACCC decision to oppose a proposed merger may be substantial. Administrative decisions that have legal status may be reviewable by the Courts under administrative law. However, no such right of review exists in relation to informal clearances.

5.7 The ACCC may regard the authorisation process as the appropriate process for parties seeking formal, appellable decisions. However, the number of authorisations sought in relation to mergers indicates that corporate Australia does not concur. This is a crucial flaw in the process. If the authorisation procedure has not been used by corporations, it is not convincing to argue that its existence is a sufficient resource for companies seeking an appropriate clearance procedure.

5.8 In other jurisdictions, the regulator's decision has a clearer legal status. For example, in New Zealand, the Commerce Commission issues a formal determination on informal clearance applications[29].

Transparency

5.9 The lack of transparency in the informal clearance procedure is not unexpected. It would perhaps be unfair to expect the ACCC to administer an informal clearance procedure that offered a relatively swift although limited and indicative view of a proposed merger and on the other hand maintain a transparent process in reaching such a decision.

5.10 However, because Australian companies have made extensive use of the informal process and largely avoided seeking authorisation, the informal clearance decision has attained a practical stature that may not have been initially anticipated by the ACCC or the legislature. In the limited time available for commercial deals to proceed, a negative informal clearance response from the ACCC may sound the death knell for a proposed acquisition. Given the often substantial funds at stake, it seems incongruous for such a crucial decision to proceed using a process that remains relatively shrouded in mystery.

5.11 A review of other jurisdictions suggests that the Australian system does not strike as effective a balance between formality and informality because, unlike New Zealand, the USA and Europe, the Australian system involves two processes (informal clearance and authorisation), only one of which is actually used for mergers.

Consistency/Accountability

5.12 For the same reasons, the informal clearance procedure has not produced a line of published reasoning that is sufficient to:

(a) allow companies considering mergers to appropriately gauge their likely prospects of success;

---

[29] Recent determinations, such as New Zealand Bus Limited and Wellington Regional Rail Limited are available at www.comcom.govtnz

(b) provide corporations which have unsuccessfully sought informal clearance with a sufficiently detailed decision to allow them to gauge their likely prospects of success in an authorisation; or

(c) provide the ACCC with specific and cogent evidence that it exercises its powers in a consistent and unbiased manner.

5.13 The fact that informal clearance does not require the regulator to publish detailed reasons is both a blessing and a curse for the ACCC. On one hand, the fact that staff papers are not required to be published or made available to the parties assists the ACCC in providing a relatively swift indicative view. On the other hand, the lack of "precedent" means the ACCC is open to public and often unfair criticism in relation to the basis of its decisions. Much of that criticism has manifested itself in emotional criticism of the ACCC itself, without reference to the procedural background against which the Commission must operate.

Apprehension of pre-determined outcome

5.14 A central issue in the relationship between the informal clearance procedure and the authorisation procedure is as a fact that the ACCC presides over both. In most cases, corporations will first seek informal clearance in relation to competition issues and then, if necessary (and if the deal is still alive) consider whether to proceed to authorisation in order to raise public benefit arguments. The difficulty with this two-stage process is that, if parties fail to convince the ACCC in relation to competition issues, they may legitimately apprehend that it is pointless to seek authorisation on public benefit grounds. The experience in the Wattyl-Taubmans merger adds some empirical support for that apprehension. That is not to say that there is any actual bias on the part of the ACCC.

5.15 However, in SFE's view the interplay between the informal clearance and authorisation process promotes an adversarial environment in which the ACCC may be prone to regard a merger as "bad" on competition grounds. The ACCC may then be disposed against the merger and be less likely to view public benefit arguments in a balanced manner. Even if such an argument is unfounded, this belief is, in SFE's view, widely held in corporate Australia. This inherent flaw places both corporations and the ACCC in a no-win situation.

5.16 The argument is particularly relevant in cases where efficiency arguments are raised. Depending upon the merger, efficiency arguments may be relevant to either competition, public benefit or both. Efficiency arguments may also be at the heart of mergers where international competitiveness is an important goal of the merged firm. In such cases, corporations are unlikely to be optimistic in relation to an authorisation application where the ACCC has indicated that it would object to the merger on competition grounds.

5.17 From SFE's perspective these issues have particular relevance. SFE's prior attempt to merge with the Australian Stock Exchange Limited was unsuccessful, but:

(a) no legally enforceable decision was made;

(b) no detailed published reasons were provided;

(c) authorisation was not sought.

5.18 Without entering into a detailed discourse of SFE's efficiency considerations, SFE believes that there were substantial and cogent reasons why a merger with the ASX should have been allowed to proceed. However, in the absence of a clear and definable procedure, it would be difficult for SFE and ASX to again pursue a merger. Of course, this result may be applauded by those who would oppose such a merger. However, the fact that the reason why a merger may not be pursued has less to do with law or policy than it has to do with procedure should not be a source of comfort for anyone.

6 Proposed Reforms

6.1 As stated above, SFE does not support a change in the substantial lessening of competition test in section 50 of the TPA.

6.2 However, for the reasons set out above, SFE would support a reform of the informal clearance and authorisation processes. Such reform should be directed toward achieving the following features and objectives:

(a) the relevance and weight of public benefit issues should be more explicitly dealt with legislation/regulations. In particular, there should be clearer legislative/regulatory criteria for dealing with efficiency arguments as they relate to both competition and public benefit;

(b) the regulator should not be encouraged to give primacy to competition issues over public benefit arguments;

(c) there should be clearer benchmarks and deadlines for the regulator;

(d) if it opposes a merger, the regulator should be required to publish detailed reasons and the contents of any expert opinions.

6.3 It may be argued that the pursuit of these goals would replace an informal process with a more formal one that would increase delay and result in further complaints from business. However, there are several reasons why a process could achieve a balance between formal and informal procedures.

(a) The merger review processes in Europe, the USA and New Zealand provide excellent points of procedural comparison. Each of those jurisdictions include procedures that are, at least in part, effective in improving predicability, transparency or in considering public benefit and efficiency arguments.

(b) There is no particular need to impose a rigidly formal process on all mergers. Where the ACCC does not object to a merger, there may be less need for formal reasons or processes.

(c) The ACCC already applies a relatively formal process. If the ACCC already produces detailed documents such as staff papers and expert analyses of markets, the provision of these to the merger parties should not substantially increase the time taken.

(d) Reforms need not be radical to improve the efficacy of the system.

(e) Even if there is a short term delay effect while corporations and the ACCC adjust to a new procedure, the creation of a body of published analyses from which

prospective merger parties may more accurately gauge risk would be likely to enhance the efficiency of the process in the medium to long term.

6.4 SFE is not the appropriate person to formulate and develop specific proposals for amending the TPA. However, there are a number of potential ways in which the current limitations of the informal clearance and authorisation processes may be improved. SFE would support :

(a) reforming the informal clearance and authorisation processes into one clearance process, pursuant to which:

(i) an application for clearance may address both competition and public benefit issues:

(ii) the ACCC has a set period during which it must either:

(A) provide informal clearance without conditions;

(B) formally authorise the merger on public benefit grounds (no separate application would be required, but the ACCC may obtain a limited extension of time if it requires additional information);

(C) formally advise the merger parties of the conditions it would require prior to granting informal clearance. If conditions cannot be agreed within a set period, (D) applies; or

(D) formally oppose the merger, stating detailed reasons in relation to both competition and public benefit issues and providing copies of any expert reports it has relied upon.

(iii) the merger parties may appeal a decision under (D) to the Australian Competition Tribunal.

(b) amendments to section 90(9A) and/or section 50(3) to make specific reference to the consideration of efficiencies.

7 Conclusion

7.1 Appropriate reforms to the informal clearance and authorisation processes would increase business confidence in the efficacy of the procedure without placing undue pressure on the regulator. For example, if companies could go straight to the regulator with a submission that addressed both competition effect and public benefit arguments, together with credible, comprehensive undertakings when appropriate, an appropriate balance between certainty, the promotion of competition and the broader interests of the public could be achieved.

7.2 SFE's research and first hand experience demonstrates that the ACCC and corporations are victims of a process that:

(a) encourages an adversarial approach;

(b) taints a deal as anti-competitive before public benefit arguments can be raised;

(c) discourages corporations from pursuing authorisations;

(d) fails to appropriately deal with arguments that are economic yet relevant to public benefit;

(e) creates a popular perception that international competitiveness is irrelevant to the process.

7.3 Whether the criticisms made of the process and the regulator are all equally valid, the practical issue remains that the process does not have the trust of the persons who must use it. For this reason alone, reform is required.

7.4 SFE has suggested a number of potential reforms in this submission. These proposals would benefit from further research and public discussion. SFE would be pleased to contribute in any further process as may be required.

Annexure 1

Comparison of Merger Law and Procedure in Other Jurisdictions

Europe

The European Council Regulation 4064/89, also known as the European Council Merger Regulation ("**ECMR**") applies to larger mergers and acquisitions which have a European Community ("**Community**") dimension. Various national competition regimes may apply to other mergers. Mergers which create or strengthen a dominant market position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it, are prohibited. The ECMR is enforced by the Merger Task Force ("**MTF**") of the Directorate-General for Competition of the European Commission (**"Commission**").

If threshold tests[30] are satisfied, it is mandatory for the parties to notify the MTF not more than one week after the earlier of the conclusion of the agreement, the announcement of a public bid or the acquisition of a controlling interest.

The transaction may not be put into effect until a final decision is adopted, unless a derogation is granted by the Commission (which is difficult to obtain).

The Commission encourages parties to conduct pre-notification meetings with the Commission. Once notified, the Commission conducts its own market inquiries, and may demand further meetings with or information from the parties.

Formal deadlines apply. The Commission must reach its first stage preliminary decision within one month of notification. If the Commission decides that the merger raises serious doubts about market dominance, it will commence a second stage of investigations, which can take up to four months, to decide whether the merger is compatible or incompatible with the common market.

Parties can negotiate undertakings with the Commission to remedy perceived competition issues. Once a decision is made, the Commission publishes a final decision, and issues a press release.

Decisions may be appealed. The EMCR provides for appeal against Commission decisions to the Court of First Instance of the European Communities on both procedural and substantive grounds. A further appeal can be made to the European Court of Justice.

---

[30] The EMCR applies to mergers and acquisition where:

(a) the aggregate worldwide turnover of the parties exceeds ∈ 5 billion; and
(b) the Community-wide turnover of each of at least two parties exceeds ∈ 250 million; unless
(c) each of the parties achieves more than two-thirds of its aggregate Community-wide turnover in one and the same member state;

or where:

(a) the aggregate worldwide turnover of the parties exceeds ∈ 2.5 billion; and
(b) the Community-wide turnover of each of at least two parties exceeds ∈ 100 million; and
(c) in each of at least three Member States, the turnover of each of at least two parties exceeds ∈ 25 million ; unless
(d) each of the parties achieves more than two-thirds of its aggregate Community-wide turnover in one and the same member state.

USA

Section 7 of the Clayton Act prohibits acquisitions of assets or stock where 'the effect of the acquisition may be substantially to lessen competition, or to tend to create a monopoly'. A merger can also be challenged under sections 1 and 2 of the Sherman Act for being an unreasonable restraint of trade or an attempt at monopolisation. The Federal Trade Commission (**"FTC"**) and the Antitrust Division of the Department of Justice are responsible for reviewing mergers for antitrust implications, pursuant to the Hart-Scott-Rodino Antitrust Improvements Act ("**HSR Act**").

Filing a notification of a merger is mandatory if the merger is sufficiently 'large' to pass certain threshold tests[31]. There is no deadline for filing a notification, but the transaction cannot take effect until the notification has been lodged and the applicable waiting period has expired. There is no scheme for voluntary filing.

Once the notifications have been filed, the FTC and the Department of Justice decide between themselves which agency will be dealing with the clearance. The agency may then contact the parties for further information or to arrange interviews or meetings. If information is not provided on this informal basis, the agency can issue a formal request for information called a Second Request.

Unless the agency decides to takes action against the merger within 30 days of the notification, once that time has expired the parties can put the merger into effect. The agency does not issue a formal decision approving the merger. However, if a Second Request is issued, the 30 days starts running from the date of substantial compliance with the Second Request. This can extend the process by months.

If the agency decides that the merger should not be allowed, the parties can negotiate a modification to the transaction or a settlement that addresses the agency's competition concerns with the agency.

If the agency decides that the merger is prohibited, and a settlement cannot be reached, the agency can apply for a preliminary injunction to block the acquisition. The agency must show that it has a 'probability of success on the merits'. If the preliminary injunction is granted that decision can be appealed.

New Zealand

Section 47 of the Commerce Act 1986 (**"Act"**) prohibits asset or share acquisitions which have, or would be likely to have the effect of substantially lessening competition. The Commerce Commission (**"Commission"**) has the responsibility for enforcing section 47. The Act authorises the Commission to grant clearances for mergers.

In considering a clearance application, the Commission conducts its own market inquiries and tests the information provided. If the merger as it stands gives rise to competitive concerns, the Act

---

[31] A merger requires notification if:

(e) the acquiring or acquired companies are engaged in US commerce or any activity affecting US commerce;

(f) the value of voting securities or assets which will be held by an acquiring party as a result of the acquisition exceeds US$50 million; and

(g) where the size of the transaction is greater than US$50 million but less than US$200 million, if one of the parties has worldwide sales or assets of US$10million or more and the other has worldwide sales or assets of US$100million or more.

permits the Commission to accept structural but not behavioural undertakings. The Commission's decision is published as a written determination.

The Act gives the Commission 10 working days in which to make a clearance decision. The Act allows for an extension of time if agreed to by the applicant. As the application is deemed to be declined if the Commission does not make an application within the prescribed time, applicants have little choice but to agree to an extension.

The Commission's determination can be appealed to the High Court. The Court can confirm, modify, or reverse the Commission's decision.

Annexure 2

Endnotes

1. In the case of a merger involving two operators of markets requiring similar infrastructure – e.g. the IT and user surveillance infrastructure used by operators of both physical/cash and derivative markets – the transaction fees charged by market operators for their services are typically much less than the cost savings achievable by users of those services from rationalising their own interfaces with separate market operator's systems and other internal systems. Unlike in other industries, customers do not automatically benefit from competition. They would not benefit where they are users of markets based around centralised price discovery and liquidity, which ensures that large volumes can be traded at competitive prices. (Fees charged by market operators are clearly important for those paying them, but liquidity is a significantly greater percentage of the customer value proposition). The utility of the network provided by the market operator increases with the number of users and centralisation of price discovery and liquidity pooling.

2. The Corporations Act singles out SFE and ASX as conducting financial services activities of such importance that anyone seeking voting power in either group in excess of 15% must establish to the Government's satisfaction that it would be in the national interest. This implies that it is in the public interest to prevent the control of those markets shifting offshore if this can be achieved in a manner that enables the operator to compete successfully with offshore based entities that have similarly achieved scale through this type of merger. Ironically, the inability of SFE to achieve such scale would be the very reason for it to partner or become owned by foreign interests in order to achieve the same ends.

3. SFE has become a focal point for debt market activity with impacts extending beyond financial market participants to encompass national interest issues about the cost of government and private sector borrowings and the integrity of the wholesale debt market payment and settlement systems. SFE's position is based on its ownership of Austraclear, clearing and settlement of Commonwealth Government Securities and its role as a central counterparty clearer of the bond and repo markets. Additionally, SFE retains its pre-eminence as the major derivatives exchange in Australia. Its capacity to continue this positive contribution to national interest issues may be at risk if control of derivatives markets in Australian debt instruments shifted to another international financial centre (because SFE had not been able to achieve adequate scale through mergers). By its very nature, the trading, clearing and settlement of products through financial market networks (exchange and clearing/settlement facilities) lends itself to significant economies of scope and scale. Systemic risk supervision of financial markets by prudential regulators ought not to favour competition between clearing entities at the expense of risk management standards. Yet the traditional competitive model unadjusted for recognition of the differences for firms that operate as networks or utilities is almost certain to produce such an outcome.

4. With offshore financial market operators becoming increasingly integrated, the attractiveness to Asian partners of the companies operating Australian markets is likely to be enhanced if the Australian market involved integrated cash/physical and derivative market operators. In addition, the ongoing fragmentation of the Australian exchanges may, in the longer term, create an imbalance of power between local exchanges and foreign ones and correspondingly, cause the global participants that are increasingly the dominant users of exchanges to flee the Australian market.