INTERNATIONAL
BANKS AND SECURITIES
ASSOCIATION OF AUSTRALIA

Review of the Competition Provisions of the *Trade Practices Act 1974*

1. Main points

- To streamline the merger assessment process, the competition test in Section 50 of the Trade Practices Act should be combined with a public benefit test including the elements already identified in Section 90 – export potential, import replacement and international competitiveness – and other relevant factors.
- Section 50 should be modified to deal with mergers that substantially lessen competition and are likely to disadvantage consumers.
- An independent expert Mergers Panel should be appointed by the Treasurer to consider contentious merger applications and resolve any differences between consumer interests and the broader national interest.
- A 30-day time limit should be set for informal clearance of mergers by the Australian Competition and Consumer Commission, with extension to 45 days in complex matters.
- The Financial Sector Advisory Council should be used as a source of advice to the Government in relation to competition policy in the financial services sector.

2. Background

IBSA represents 39 foreign and domestic investment banks and securities companies operating in the Australian market. Our members include the leading corporate advisers on mergers and acquisitions. A list of members is attached.

One of the defining characteristics of IBSA's members is the international nature of their business – either as global financial houses, major regional banks or Australian banks with significant offshore business.

IBSA's members primarily serve the Australian market, although many also use Australia as a base for the export of financial services, particularly into the Asia-Pacific region.

The strong presence of international banks and securities companies in Australia is the result of Government policy in the 1980s and 1990s to open up the financial markets to competition, improve the quality and efficiency of financial services and to position Australia as a competitive player in the global economy.

The success of this policy is reflected in:

- Greater competition in wholesale and retail financial services to the benefit of corporate and private customers in Australia. At June 2002, 50 authorized banks competed in the wholesale and retail markets, 36 of them foreign.
- The integration of Australian markets into the world financial system, with Sydney emerging as a significant financial centre in the Asian time zone.

- Financial product innovation that helps make Australian companies globally competitive.
- Sophisticated financial skills and employment opportunities.

Against this background, IBSA welcomes the current review of the Trade Practices Act as an opportunity to fine tune the competition provisions of the Act so they encourage competition in domestic markets and, at the same time, increase the capabilities and opportunities for Australian firms to participate in an increasingly globalised market.

3. Scope of submission

This submission concentrates on the merger provisions in Section 50, the part of the Act that is most relevant to the business activities of our members. Many offer corporate advisory and financial services in relation to merger and acquisition proposals.

The submission is based on discussions with our members engaged in mergers and acquisitions practice and with professional advisers in this field.

It does not canvass business conduct and other aspects of the Act under review, except to make the general observation that the Act as it stands gives substantial power to the ACCC to meet its responsibilities.

IBSA agrees with the Business Council of Australia that greater checks and balances are needed for the ACCC. We suggest in the case of merger approvals that the process would be assisted by the appointment of a Mergers Panel to provide such checks and balances in determining complex and contentious cases.

4. Mergers – competition and public benefit tests

Similar jurisdictions around the world have merger controls based variously on lessening of competition, market domination or public benefit. Australia has moved from a market domination test to a substantial lessening of competition test. This is applied by the ACCC in the first stage of assessing a merger. The public benefits test is applied as a separate process if the merger proponents seek authorisation.

At a time when strategic business decisions may need to be taken quickly, this two-stage process can be cumbersome, time consuming and create uncertainty of outcome.

This submission argues for a streamlined mergers assessment process in which the competition test and the public benefit test are combined in one stage. It can be anticipated that, as happens now, most mergers assessed in this way will not be opposed by the ACCC. Contentious mergers should be referred to an independent Mergers Panel where an objective judgment will be made after consideration of the views of the ACCC and the merger proponents.

Competition policy is one of a suite of official policies designed to foster an efficient and strong economy, which benefits both business and consumers. These include personal and business tax reforms, finance sector regulation, corporate law reform and trade policy.

A key objective of the corporate law and economic reform process (CLERP) is to stimulate a market for corporate control in which good management succeeds and poor management is overtaken. Mergers are an important means to this objective.

The common objective of these policies is to position Australia as an internationally competitive economy with the ability to export successfully and maintain a strong

domestic economy with high levels of employment and good living standards. It is important that competition law and its administration are consistent with these overall objectives.

As the Act is presently structured and administered, these important broader considerations are not taken into account when the ACCC is assessing the merger factors contained in Section 50 (3). Although it covers 9 specified merger factors, the competition test is relatively narrow. It is limited to deciding whether a merger would substantially lessen competition and does not have regard to wider economic objectives.

In other stages of the merger approval process, if authorisation is sought or the merger is referred to a higher authority, a wider view is taken. Reference to international competitiveness is contained in the ACCC's Merger Guidelines, in the Act itself and in judgments of the Competition Tribunal.

The existing public benefit test in Section 90 for authorisation of mergers that may lessen competition specifies additional factors the ACCC must take into account:

- export potential
- import replacement and,
- international competitiveness (a broad concept embracing many economic factors).

However, these factors are only considered if the merger proposal is submitted for formal authorisation. This presents companies with a difficult choice – whether to try for informal clearance knowing that if the ACCC becomes of a mind to oppose the merger, this will make authorisation more problematic; or whether, in effect, to concede the merger is anti-competitive and seek authorisation at the outset. It would be interesting to analyse why 53 mergers did not proceed from 1993-2002 because they were opposed by the ACCC and why only 12 mergers were proposed for authorisation. If some of these opposed mergers might have potentially provided benefits to the Australian economy, but were not put to the test, this was an opportunity cost to the economy and the public.

IBSA believes there is merit in changing the merger approval process to combine the competition test and the public interest test in a one-stage process. This would require the ACCC to assess all mergers referred to it in terms of their likely impact on competition and consumer welfare and whether they would be compatible with broader economic and social objectives. These could include:

- The potential for a merged entity to provide better products and services to Australian consumers even if competition is lessened.
- Improvement in economic efficiency, including better allocation of capital and human resources.
- Enhancement of management efficiency – the market for corporate control – in accordance with the CLERP objectives.
- Potential for increased exports.
- Replacement of imports.
- The ability of Australian companies to compete more effectively in international markets.
- Creation and maintenance of employment.
- Better returns for investors (a relevant factor given the national goal of self-sufficiency in retirement).

A similar but even more comprehensive list, with references to industrial harmony and protection of the environment, is contained in the Merger Guidelines at 6.38.

In dealing with mergers in the way we suggest, the ACCC would still need to consider whether the proposed merger would lessen competition to the detriment of consumers, working through the merger factors listed in Section 50 (3). If the answer was 'no', the ACCC would indicate it would not oppose the merger. If the answer were 'yes' or 'maybe', the ACCC would then automatically assess whether the merger was in the public interest when measured against national economic objectives of the sort outlined above.

The advantages of this approach are:

- Including the public benefit test at an earlier stage of the process will streamline consideration of mergers. The ACCC will be able to make a judgment earlier in the process about whether mergers that might be marginal under the mergers test would nonetheless pass under a public benefit test, saving time and resources for both the ACCC and the merger parties, and avoiding the need for some mergers to go through the more formal and time-consuming authorisation process. We expect the 98% of mergers that are ultimately approved under the existing process would also be approved under the process we recommend, but more efficiently and with less uncertainty of process and outcome for the merger parties.
- Companies wishing to merge could put their case not only in terms of the competition criteria, but also in terms of wider economic and public benefits that would result from the merger, knowing that in their consideration of the merger, both the ACCC and, if necessary, the Mergers Panel would balance competition factors against other policy objectives.
- Companies would feel more confident about approaching the ACCC with a merger proposal, including those that might otherwise not proceed with a proposal because of even a modest risk of a knock-back from the ACCC on the competition test.
- Companies would also have more confidence in the process because in the event the ACCC was opposed to the merger; they would know their proposal would be considered by the Mergers Panel against commercially realistic criteria.
- There is also a general view in business that while the authorisation test includes appropriate public interest considerations, the authorisation process itself is not commercially attractive and is not working as well as it should. The amendments we suggest to the merger test will facilitate consideration of important public benefits in a greater number of mergers and hence lead to improved efficiencies and economic and social benefits.

The benefits of this change in procedure would be:

- to streamline the merger assessment process
- provide greater certainty of process for companies wishing to merge
- provide a fulcrum for balancing the ACCC's role as a consumer and competition champion with wider economic and social objectives in the public interest.

Recommendation 1:

Section 50 should be amended so the competition test is applied to give greater weight to broader economic objectives, including international competitiveness, economic efficiency, exports v imports, investment returns and employment.

5. Consumer disadvantage

Consumers benefit from competition but consumer welfare is not measured solely by the degree of competition in a market. Other factors such as the quality, sustainability and cost of products and services are also important. Consumer welfare is also enhanced by international competitiveness, a strong domestic economy and high employment.

It should not be assumed that every lessening of competition will necessarily disadvantage consumers. Arguably, it could be a better or at least neutral outcome for consumers if a merger results in fewer companies competing in a market, but those companies are more viable and able to sustainably deliver better products and services at the same or even lower cost to Australian consumers. It is recognised that this is mainly a question of whether appropriate weight is given to the word "substantially" in the current merger test. The additional requirement of "significant disadvantage" will better define the consumer protection intent of competition law and give the ACCC clearer criteria for making a judgment on mergers.

Recommendation 2:

Section 50 should be amended to refer to mergers that would substantially lessen competition and are likely to significantly disadvantage consumers.

6. Expert Mergers Panel to review difficult cases

In the minority of complex or contentious cases where a difference of view arises between the merger parties and the ACCC, it would be advantageous for all concerned to have the opportunity to refer the case to an independent expert Mergers Panel. The Panel would make an objective assessment of the arguments put by the merger parties and by the ACCC – taking into account competition, consumer and public benefit factors – and make a decision on whether the merger should proceed and if so, under what conditions.

The Panel would perform a useful role in reviewing the facts and principles involved in a contentious merger proposal and balancing the ACCC's consumer protection responsibilities against the public or national interest. The Panel would need to work from a set of principles that would essentially help it judge whether consumers would be better or worse off under a proposed merger and whether broader public or national interest objectives would outweigh any possible reduction in consumer welfare.

The Mergers Panel would be similar in concept to the Takeovers Panel, which reviews decisions of the Australian Securities and Investments Commission and has substantial powers to make orders in relation to exemptions and modifications of the Corporations Act, and to review ASIC decisions relating to takeovers. In determining where consumer interests and public benefit lies, the Mergers Panel would rely on a set of principles similar to the Eggleston Principles, which guide the Takeovers Panel.

Referral of a merger proposal to a Mergers Panel would be at the option of either the merger parties or the ACCC when it is clear there is disagreement over the competitive effect of a merger. This might arise during consideration of the combined competition and public benefits test under a revised Section 50 and would certainly be clear if the ACCC decided to oppose a merger or sought undertakings unacceptable to the merger parties.

The decision of the Panel on a merger would have to be accepted by the merger proponents and by the ACCC. However, there would still be a right of appeal to the Australian Competition Tribunal on a matter of process or proper application of the law.

The ACCC would not be able to seek a Federal Court injunction against a merger once it had been referred to the Mergers Panel. However it would still have the option of seeking an injunction to prevent or unwind a merger that goes ahead without reference to the ACCC.

The Mergers Panel should have responsibility for making a final determination on mergers on balanced consideration of the circumstances. The Panel provides the forum in which the ACCC, fulfilling its primary role as consumer and competition advocate, spells out its concerns about a merger while the merger proponents put their case.

The Panel would need to be comprised of fair minded and knowledgeable people with extensive business, commercial law and public policy experience. The Treasurer would appoint members of the Panel.

In the event a matter is taken to the Panel, it would need to be convened quickly and the matter dealt with expeditiously.

We anticipate they would need to become engaged in settling very few merger applications. Experience with the present system suggests 2-5% of mergers taken to the ACCC might be referred to the Mergers Panel, however this rate of referral might change if a new process for dealing with mergers encouraged more to be put to the test.

The diagram in Appendix 1 illustrates the differences between the current mergers approval process and the streamlined process suggested in this submission.

Recommendation 3:

An independent, expert Mergers Panel should be appointed by the Treasurer to determine the outcome of mergers where the merger parties and the ACCC are unable to agree.

If the TPA review does not accept our proposal for a Mergers Panel, we would support as an alternative the recommendation of the Business Council of Australia for merger proponents to be able to refer a merger to the Competition Tribunal provided faster procedures and limited appeal rights were instituted.

7. Informal clearance processes

IBSA acknowledges that the ACCC does not object to the majority of mergers and that, after conditions are agreed in the case of some mergers, only about 2% are opposed. This is not a surprising result as under the present system most of the mergers proposed would be those where the proponents judge it would stand a good chance of getting though the competition test. However, it does not take account of mergers that may be conceived at board level but are not taken to the ACCC out of concern they would be opposed and there would be no practical forum to test whether they would actually result in disadvantage to consumers and, if so, whether this would be outweighed by the national interest. It is not possible to say how many potential mergers might not eventuate for this reason.

IBSA members report that the main concerns of their corporate clients about the ACCC approval process, whether they go ahead or not, are:

- Uncertainty of outcome
- Delays in making decisions
- Confidentiality of information provided
- Transparency

These factors can lead to some lack of confidence in the process.

Uncertainty of outcome

We accept that certainty of outcome is not easily delivered when administration of the Act can require fine judgments to be made on complex situations. The introduction of a general public interest test earlier in the approval process, as outlined above, should assist merger parties to make a more realistic assessment of their chances of getting clearance. Also, the opportunity to test the ACCC's approach in a review forum such as the Mergers Panel we propose would give business greater confidence in the process.

Process delays

The Merger Guidelines give estimates of the time the ACCC expects to take in dealing with informal clearances, however these do not impose any discipline on the ACCC to deal with applications to a timetable. Trade practices lawyers advise IBSA that where a merger is opposed, it will usually take 1-2 months and can take in more complex matters 2-4 months for the ACCC to make enquiries and reach a final decision. The ACCC's submission to the review shows that in 1999-2000, some 65 out of 220 informal clearance matters (25%) took longer than 9 weeks to resolve and in 2000-2001, 45 matters out of 265 (17%) took longer than 9 weeks. In its Merger Guidelines, the ACCC stated that: "in those few major cases which raise very substantial issues and with which the Commission is likely to have a problem, the Commission may take 6-8 weeks to full consider the matter". On its own numbers, an increasing number of mergers are exceeding the ACCC's own timeframes.

We suggest that the 30-day time limit under Section 90 (11) should also apply to informal clearances under Section 50 with the same consequence – that is, if the ACCC has not made a decision, or at least offered an indicative view, within 30 days of notification, the proposed merger shall be deemed to be free to proceed. This is predicated on the assumption that the applicant has provided all relevant information required by the ACCC to make a decision.

In mergers of some complexity, the ACCC could be allowed to advise the parties that the period would be extended to 45 days in line with the existing requirement in the Act for the more complex process of authorisation.

We recognise that including a legislated formal timeframe in an informal clearance process is difficult and accordingly we suggest the time limits should be set in the Merger Guidelines.

Confidentiality

It is accepted the ACCC needs, in many cases, to make market inquiries to gauge the competitive effect of a merger and in doing so it endeavours to respect the commercial confidentiality of information provided – in particular that sensitive information provided to the ACCC by applicants should not be revealed to competitors. Nonetheless, some companies may be nervous about providing such information. A clear protocol for dealing with commercially sensitive information may need to be developed by the ACCC. This would give merger parties a greater measure of comfort and confidence in submitting confidential material.

Transparency

IBSA members report that a problem they and their clients sometimes encounter is that the ACCC makes decisions on a merger proposal after consulting with other participants in the market. However, there is no opportunity for the merger parties to know what is said by others, nor to challenge the veracity and logic of the information and arguments put to the ACCC by their competitors. The ACCC approvals process should provide an opportunity to test claims or comments made by interested third parties. Confidentiality issues for third parties need to be balanced against the ability of merger proponents to adequately test information provided to the ACCC.

A second concern about transparency relates to ACCC decisions, which do not sufficiently explain the ACCC's reasons. Often only a brief general explanation for the decision is provided. While the ACCC may feel constrained by the possibility of further action by merger parties, it should be possible to provide reasons in sufficient detail for the parties to clearly understand the ACCC's position and take it into account in considering their options. We accept their may be practical limits to the amount of time ACCC staff can devote to preparing reasons for publication and this may mean more detailed explanations are limited to major mergers or where the merger parties request reasons for decisions.

Recommendation 4:

The Merger Guidelines should commit the ACCC to a 30-day limit to respond to merger notifications under the Section 50 provisions, with an option for the ACCC to extend the process to 45 days in complex matters.

The Merger Guidelines should include a protocol for managing commercially confidential information provided by merger parties.

ACCC merger assessment processes should provide an opportunity for applicants to access and test the information and arguments provided by other market participants consulted by the ACCC.

ACCC should provide adequate reasons for the position it takes on mergers, at least in major matters or where the merger parties ask for reasons to be given.

8. Authorisation

Under the new arrangements we have proposed, there would be no need for a formal authorisation process. Mergers would either not be opposed by the ACCC or they would go to the Mergers Panel for determination. However, if an authorisation process is to remain in the Act, a more disciplined approach to dealing with applications is necessary.

IBSA members advise that some authorisations can take up to 6 months to be dealt with despite the requirement in Section 90 that authorisations be decided within 30 days or within an extended period of 45 days at the ACCC's discretion or longer by agreement with the parties. The cause of the delays appears to be the need for the ACCC to make market enquiries. In merger situations where urgent business decisions may need to be made, speedier decisions are required from the ACCC and the 45 day limit set in the Act should be adhered to, except in the most complex matters were an extension of time can be justified. In these matters, the ACCC should give the merger parties a firm date for completion.

Recommendation 5:

The limit of 45 days for authorisation should be adhered to in all but the most complex matters. In these matters the ACCC should give the merger parties a firm date for a decision.

9. Competition issues in the financial services sector.

When competition policy issues arise in the financial services sector, the Government could find value in seeking high-level advice. A mechanism already exists in the Financial Sector Advisory Council. The Council brings together leaders in the financial sector to provide the best advice available to the Treasurer on policies to facilitate the growth of a strong and competitive financial system. An important focus of the Council's activity is the prudential supervision and market conduct regulation of the financial sector. The Council could also perform a useful role in considering competition issues in the financial sector and advising the Treasurer on the appropriate policy course.

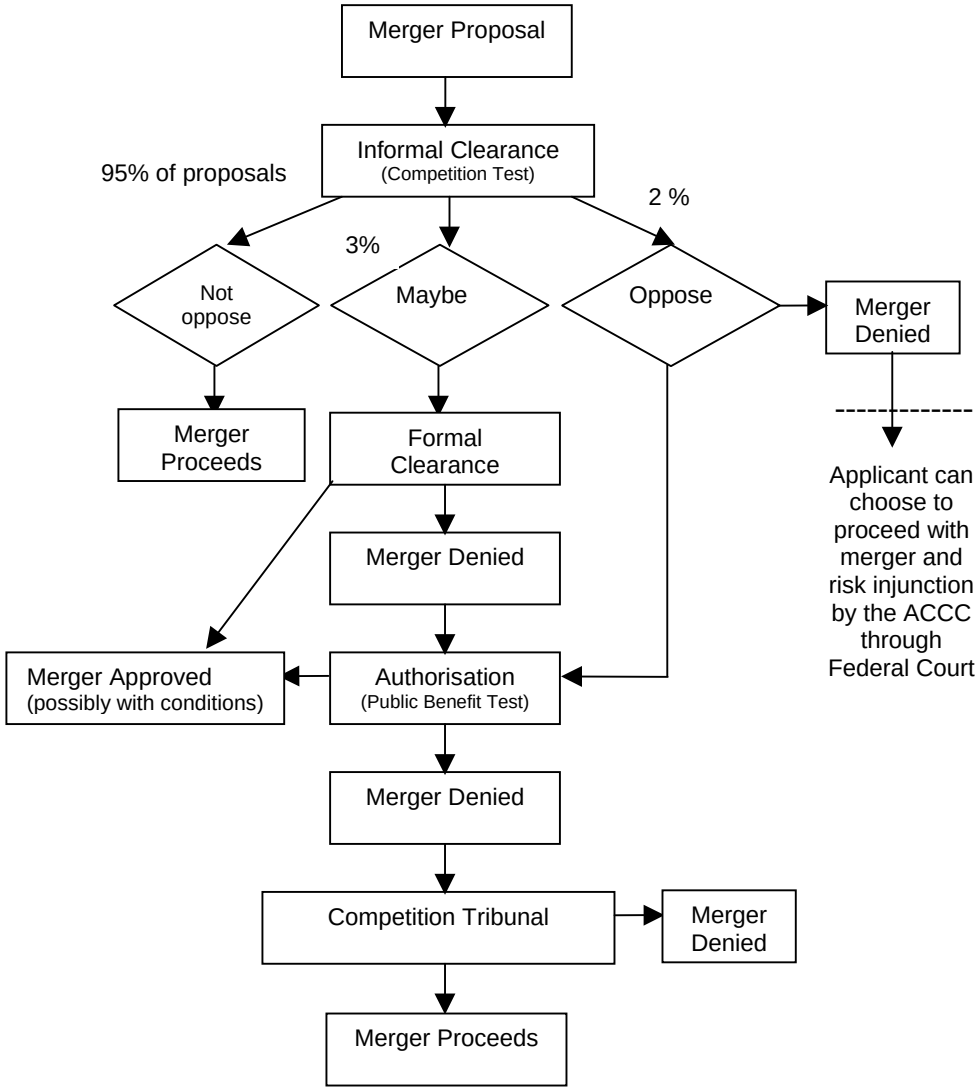
The primary focus for public policy relating to financial institutions is on financial system stability and integrity. Beyond this, financial institutions should not be subjected to competition or corporate law any more onerous than for other business sectors.

Recommendation 6:

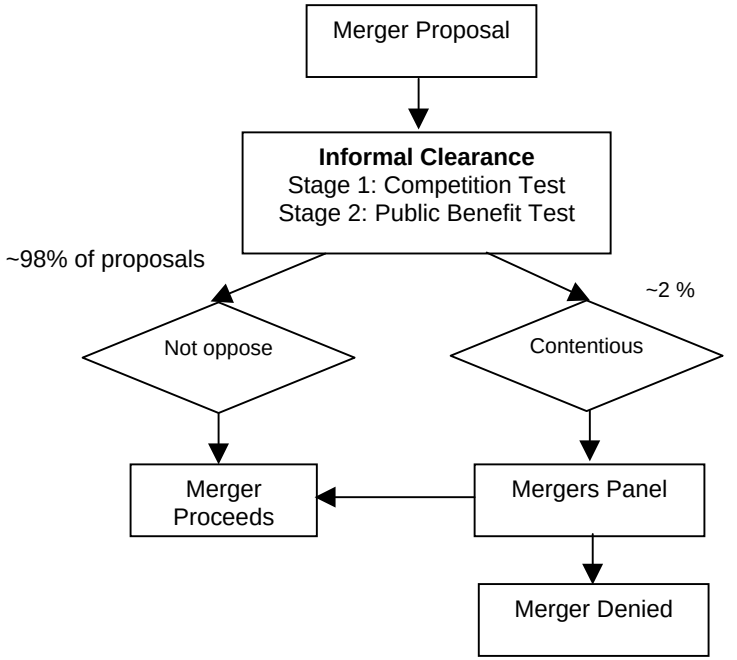
The Review should recommend that on competition policy issues affecting the financial services sector, the Government should consider seeking advice from FSAC.

Appendix 1

Current Process



Streamlined Process



Appeal rights to Competition Tribunal on matters of law