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Secretary
Trade Practices Act Review
C/ - Department of the Treasury
Langton Crescent
PARKES ACT 2600

July 22, 2002

Dear Sir,

We wish to make a submission to the Committee of Inquiry into the competition provisions of the Trade Practices Act 1974 (the "Act"), and their administration.

As a leading investment bank, UBS Warburg has played an active role in capital markets and mergers and thereby in the debate for reform of the Act and its administration.

We are very pleased that the review is occurring, and that we are able to participate in the reform process. Our focus is upon the merger provisions, including a discussion of capital markets impacts.

Our suggested changes include the separation of responsibilities of the ACCC and amendments to section 50 to improve the consideration of broader public benefits.

Australia, although geographically isolated, is no longer a discrete market. Flows of capital and labour, especially skilled labour, are almost total. Thus Australian companies compete in global markets for people and capital, as well as in goods and services.

We consider that Australian companies, regulators and other market participants must have absolute best practice to be competitive in this environment, otherwise Australia will not achieve the significant benefits both of globalisation and of free enterprise generally. In this context, this review of the Act is necessary and timely.

Please contact Peter Nelson on (02) 9324 2688 or me directly on (02) 9324 2475 should you wish to discuss any of the matters discussed in this submission further.

Yours faithfully,

Chris Mackay

UBS Warburg

Review of the Trade Practices Act

Submission by UBS Warburg Australia Limited

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Introduction

This submission is made by UBS Warburg Australia Limited for consideration by members of the Federal Government Committee of Inquiry into the competition provisions of the Trade Practices Act 1974 (the "Act"), and their administration.

UBS Warburg has played an active role in the debate for reform of the Act and its administration. Our perspective is as the leading capital raising house in Australia, the leader in advising on mergers and acquisitions, the number one broker in terms of Australian Stock Exchange turnover, and as a leading international investment bank.

In the last five years we have advised on in excess of 200 merger and acquisition transactions with a total value in excess of $200 billion dollars and have assisted Australian companies raise over $40 billion dollars.

We have a unique insight into the factors influencing the ability of Australian companies to compete globally and the effects of the Act on both global expansion by Australian companies and on capital markets and direct investment in Australia.

Australia, although geographically isolated, is no longer a discrete market. Flows of capital and labour, especially skilled labour, are almost total and as such Australian companies compete globally for capital and labour, as well as in markets for goods and services. Australian companies, regulators and other market participants must have absolute best practice to be competitive in this environment.

Australia has the opportunity to capture the massive social and commercial value that capitalism and globalisation create as the exposure of the Australian economy to international competition increases. Regulatory or political restrictions to free markets have clear costs in terms of loss of efficiencies, which may reduce these benefits.

Similarly, in our view, the attraction of global capital should be a primary objective of government policy in order to maintain the economic growth sufficient to support life style and infrastructure objectives. Australia's regulatory processes need to be flexible enough to make determinations in an efficient and effective manner. Otherwise regulatory processes are impediments to the flow of capital and ideas within, and into, Australia.

We support the Act and its pro competition / pro consumer intent; however we feel that updating and amending it is required in light of experience. In particular, we believe that the competition provisions of the Act, in their current form, and their administration, do not provide an efficient and practical avenue for Australian companies to seek regulatory approval for merger transactions. Thus, we suggest the following changes:

- separation of the prosecutorial and merger regulatory functions of the ACCC ;
- changes to section 50 so that a merger is only rejected if any reduction in competition outweighs the public benefits of a merger;
- the introduction of an independent panel as a first point of review on rejected mergers and as a body to establish an improved body of precedents, guidelines and rulings to assist participants;
- in considering public benefits, allow applicants to submit on implications on the attraction of global capital;
- greater transparency in ACCC decisions;
- improved "market" definitions to take account of the free flow of capital and labour, especially skilled labour.

We also believe that the introduction of an effects test to section 46 of the Act would have a very material negative effect on the attraction of capital to Australia and Australia's reputation for domestic and international investors. This would seriously penalise successful Australian companies in comparison with less successful competitors and is directly contrary to the underlying tenets of free enterprise.

Introduction (continued)

A key point to bear in mind is that Australian and international managers of retirement savings exercise their judgement to maximise returns. Thus, for Australia's economy reliant on capital investment, efficient and fair regulation is a fundamental requirement to attract such capital in comparison with other geographies.

The background to our suggested changes is discussed further in the following pages.

Australian capital markets must be internationally competitive to attract capital and maintain economic growth sufficient to support life style and infrastructure objectives

Australia's regulatory environment is a key factor in the attractiveness of our capital markets and the ability of Australian companies to compete successfully.

The Australian Stock Exchange represents less than 2% of the world's stock market capitalisation and as a result our capital markets must be internationally competitive to attract capital and maintain economic growth sufficient to support life style and infrastructure objectives.

As global fund managers increasingly invest on a sector, rather than geographical basis, it is no longer automatic that investment capital will come to geographic regions, such as Australia. However, there is an increased focus by some global fund managers on some Australian companies, where they are seen to be globally or regionally competitive and offer relatively attractive returns on capital. Australian fund managers are also increasingly investing globally.

Australian companies, public and government, can access some capital previously unavailable to them, however it is allocated unequally and capital inflows are increasingly volatile for most countries. Direct (rather than portfolio) investment is less fluid than indirect investment, but there are a larger number of attractive direct investment geographies decade by decade as, for example, previous socialist countries open up to capitalism.

In our view future Australian standards of living and economic strength require Australia to be an attractive investment destination. In turn, this requires regulation that is sympathetic to the ongoing attraction of capital. Recent economic strength in Australia has both contributed to and benefited from strong capital markets in Australia, which have in turn been supported by sensible regulation, particularly securities regulation. We submit that it is now time to modify the Act and an objective should be to maintain or improve Australia's competitiveness and attractiveness for investment.

Australia's strong economic fundamentals, innovative and sensible capital management and capital market techniques have contributed to attract investor capital, both domestic and global. Strong disclosure standards and accounting practices also advantage Australian companies. However, in our view, uncertainty in relation to administration of the Act has acted as a disincentive for capital investment.

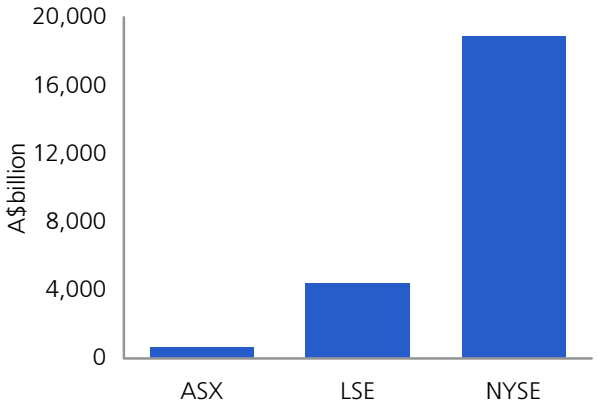
Australian Capital markets are performing relatively well, demonstrating a resilience to global capital market movements. For example, the ASX All Ordinaries has outperformed the Dow Jones and FTSE indices by 6% and 12% respectively over the twelve months to 30 June 2002.

Further, in 2001, over $18 billion was raised on the ASX for Australian companies' capital requirements, representing approximately 2.5% of the market capitalisation of the ASX. In the first half of this year $8.8 billion has been raised on the ASX.

The following graphs illustrate, firstly, the small size of the Australian equity markets in comparison with both New York and London, and the significant amount of fresh capital that is raised each year by ASX listed entities.

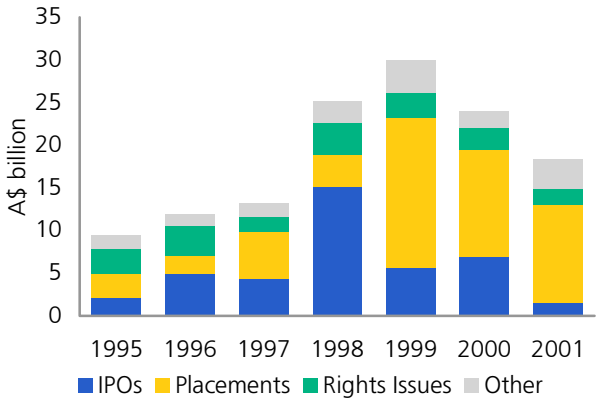
Australian capital markets (continued)

Relative size of Australian equity market



SOURCE: Bloomberg, LSE, ASX

Australian capital raisings



SOURCE: ASX Annual Reports , ASX Monthly Index Analysis

Given the above graphs, it is obvious that Australian market participants and regulators should be focussed on achieving absolute best practice in order to counteract obvious disadvantages of market size and geographic isolation.

We believe that in conducting any review of Australia's regulatory practices, such as this review, primary consideration should be given to improving global competitiveness of our capital markets and the ability to attract capital.

Please note that we are not simplistically arguing that either merger laws or their enforcement should be relaxed in favour of larger Australian companies. In our view, it is also not simply a matter of creating a few "national champions", although many Australian companies are utilising their strong domestic positions to attract capital and grow internationally.

Australia's competition regulation should allow the creation of internationally competitive Australian companies that attract business activity and capital investment

The ACCC has noted that, in general, Australian competition policy must balance sometimes competing objectives, including:

- allowing Australian industry to achieve the economies of scale necessary for international competitiveness; and
- promoting domestic competition and preventing abuses of market power.

As a geographically isolated economy there are clear costs associated with restricting market forces, especially in impediments to capital flow. Whilst domestic competition is an important component in promoting efficiency and productivity, significant consideration needs to be given to the ability of Australian companies to obtain the economies of scale necessary to compete internationally and, importantly, to attract global investors. The attraction of global investors reduces a company's cost of capital and improves its competitiveness and the competitiveness and efficiency of the Australian economy.

Fuelled by global industry consolidation, corporate law reform, a low Australian dollar and available capital, Australia has seen a rise in merger and acquisition activity in recent years. In 2001 nearly 54% of merger and acquisition activity involved foreign acquirers, reflecting the increasing globalisation of our markets.

Australian companies are also increasingly showing a willingness to acquire offshore, as demonstrated by the following transactions:

- BHP's merger with UK group Billiton
- Fosters' takeover of Beringer Wines of California
- Westfield's acquisition of Rodamco North America
- Macquarie Infrastructure Group's investments in Highway 407 in North America
- Telstra's investment in Pacific Century Cyberworks in Hong Kong
- Amcor's acquisition of Schmalbach PET in Europe
- CSL's acquisition of US Plasma Collection Business
- Macquarie Airport's acquisition of Aeroporti di Roma SpA
- Paperlinx acquisition of Bunzl Fine Paper in the UK

UBS Warburg helped the Australian companies raise capital for, or advised on, each of these acquisitions. We believe that capital markets support in large part depended upon the strong domestic position of the acquirers, in some cases established under more permissive trade practices regulations.

Despite their being limited popularity for the "national champion" argument, it is irrefutable that the vast majority of our successful global companies have grown from at least a very strong domestic position.

UBS Warburg believes the current regulatory approval process does not adequately provide a commercially practical process for considering public benefits of proposed mergers and acquisitions. Whilst the current Authorisation process does provide an avenue for assessing broader public benefits, such as job savings, efficiency gains, environmental benefits, and global competitiveness, this is only available after a merger has been rejected under section 50. The burden is then on the applicant to show public benefits to gain Authorisation.

Mergers & Acquisitions (continued)

Uncertainty in relation to outcome, the reversal of the burden of evidence, and the lengthy timeframe often involved makes Australian companies vulnerable to both market movements and competitors whilst awaiting a decision. In many cases, companies are unwilling to propose economically sensible mergers because of the risks to their business of uncertain processes and bad publicity.

The inadequacies of the Authorisation process are reflected in the very few times it has been used, and the well publicised experiences of Wattyl when it sought Authorisation of the Taubmans acquisition.

Currently, ACCC decisions are seldom challenged and the result is an absence of accountability. Our suggested changes to the administration of the Act include the introduction of an independent panel as a first point of review for rejected mergers to ensure that this is addressed.

In situations where there is substantial import competition, the ACCC has generally permitted significant market concentration such as in the Email/Southcorp, Smorgon Steel/Email and GWA(Caroma)/James Hardie(Fowler) mergers. However, import competition is only one aspect (given freedom of movement of capital and labour, particularly skilled labour). Where import competition is not as prevalent, the current provisions of the Act do not enable sufficiently broad consideration of public benefits beyond domestic competition under section 50.

In addition, the current provisions of the Act place too great a focus on Australia's regional sub markets for the good or service and thus the focus in some mergers is upon competitiveness in very narrow areas, without any consideration of impact upon broader capital flows.

We also argue for a separation of ACCC powers. Put most simply, how would a proposed merger between downstream oil companies be treated by the ACCC? Given overcapacity, inefficiency and failure to reinvest because of poor returns, such a merger would have benefits. However, given the battle to win public opinion in its current investigation and prosecution attempts, the appropriateness of the ACCC to determine any such merger application would be questionable by many.

Other submissions have considered the ACCC's use of the media. All we will say is that the oil company "raids" received very prominent attention in the worlds' financial capitals and caused investor concern as they carried with them a presumption of guilt and failure of controls borne out of the ACCC's use of the media. Australia's corporate reputation has not yet overcome the "Cowboy Capitalism" issues of the 1980's (witness, for example, the comments critical of Australian regulation by the highly respected Charles T Munger, Vice Chairman of Berkshire Hathaway, in his recent AGM address and the press coverage they received).

We also submit that in some cases the conditions attaching to approval/authorisation should reflect capital flows (for example, approved subject to an investment [in new plant and equipment] of $X over [period]). Such flexibility in applying conditions requiring investment would be a consequence of improved and more balanced focus upon public benefits, such as capital investment leading to greater efficiency.

An improvement in the authorisation mechanism, and in particular combining the consideration of competition effects and public benefits, would allow applicants to make submissions regarding the benefits and for these submissions to form the basis of undertakings/conditions of approval.

We also believe that both the ACCC and business would benefit from cross-pollination of ideas through the secondment of appropriate personnel both from the ACCC into business and from business into the ACCC. Clearly appropriate safeguards need to be worked through, but the concept will allow greater understanding of business on the part of the ACCC and vice versa.

Suggested changes

Separation of ACCC responsibilities

We favour the separation of the merger review and Authorisation processes of the ACCC from its prosecutorial and other regulatory arms.

As a regulator of section 50 and Authorisations and a prosecutor, handing out significant penalties under a range of powers, the ACCC, we believe, is correctly regarded as the most powerful regulator in Australia.

As a result of these combined responsibilities, ACCC views are effectively law prior to a court ruling. We believe that this approach is flawed, and in practice may result in an inability of some applicants to enter into constructive dialogue with the ACCC. Rather, it provides for a confrontational approach with applicants being deterred from making economically sensible investment decisions. The absence of a conciliatory approach in the current clearance process restricts the ability of the applicant and the ACCC to negotiate attractive structural and undertaking compromises.

Allow all the implications for the national interest to be addressed simultaneously in one process

We believe the current approval process should be simplified such that a merger proposal is only rejected under section 50 if "any resultant reduction in competition outweighs the public benefit". This would allow all the implications for the public benefit/national interest to be addressed simultaneously in one process. In our view, in considering the public benefit, greater emphasis should be placed on the ability of Australian companies to attract capital.

The current Authorisation process does not provide a commercially practical mechanism for balancing domestic competition issues with the broader public benefits of proposed mergers. Whilst section 88 permits the ACCC to authorise mergers that lead to or may be likely to lead to a substantial lessening of competition, Authorisation is only relevant if the ACCC determines that the applicant has a section 50 issue (ie the ACCC requires an applicant to concede the section 50 issue before allowing an Authorisation). This is procedurally unfair, uncertain and discourages merger proposals.

Allow applicants to submit on implication on direct and portfolio investment

The current competition provisions of the Act fail to recognise the almost total free flow of capital and labour into and out of Australia and the necessity of attracting capital.

We believe that in considering broader public benefits of a merger, applicants should expressly be allowed to submit on any likely implications on direct and portfolio investment relevant to their application. We also believe that similar provisions should be added to the preamble to the merger provisions in the Act and in illustrating Undertakings that might be given (ie a purpose of the Act).

Improve "market" definition

The current definitions of market for the purposes of section 50 focuses on states, regions and territories of Australia. The practical reality is that Australian companies compete above a regional level and the definition of market should take into account the flow of capital and labour, especially skilled labour, into and out of Australia.

Suggested changes (continued)

Introduce an independent panel as a first point of review.

We suggest the introduction of an independent panel as a first point of review of rejected mergers to provide a workable, timely and fair appeal mechanism. Alternatively applicants could choose to apply directly to the panel rather than wait for an ACCC decision. We envisage that the panel would operate in a similar manner to the Takeovers Panel, separate from the ACCC and including community members.

Combined with the suggested amendment to section 50, this amendment will increase the confidence of the business community and the public in the effectiveness of our competition and merger regulation. Accountability and transparency will improve with this mechanism and it will help the current common complaint that the ACCC fails to publish adequately detailed reasons for its decisions.

We also believe that a review panel should be required to give "post decision reviews" 1, and 3 years after decisions. This would allow regulators, politicians, business people and public to learn from the implications of decisions. We believe that a post decision review of decisions made in recent years would be instructive. We believe that observers would be surprised to learn how effective competition has been.

For example, one of the richest families in the world, the Albrechts, have introduced Aldi as a new grocery retail competitor; some of the industries where mergers were not permitted or restricted (such as paint and downstream oil) are marked by inefficiency, lack of rationalisation and have failed to attract capital. Consumers, and the economy as a whole, have not benefited.

We also believe that the panel could establish an improved body of precedents, guidelines and rulings to improve transparency and assist market participants.

Effects test

The introduction of an effects test into section 46 would effectively penalise Australian companies for being successful. This would have a negative effect on the attraction of capital to Australia.

Rather than promoting competitive Australian companies, an effects test for misuse of market power would protect less efficient operators as companies would be severely hampered in their ability to take "normal" competitive actions and, for example, respond to new competitors in the market, including those from offshore. Self evidently, such provision would be directly contrary to the spirit of free enterprise.