10.10.08

Mr Scott Rogers
Competition & Consumer Policy Division
The Treasury
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Dear Mr Rogers

Creeping Acquisitions Discussion Paper

Coles appreciates the opportunity to comment on the Creeping Acquisitions Discussion Paper issued by The Treasury on 1 September 2008.

No need for change

Coles is concerned that each of the proposed "creeping acquisition" models set out in the Discussion Paper involve significant amendments to the operation of the current mergers test in the *Trade Practices Act,* in circumstances where there is no demonstrated need for change.

Coles is not aware of any specific examples ever being cited, or any specific evidence being put forward in relation to the retail market, to support a current need for a specific creeping acquisitions law. To the contrary:

1. the detailed Dawson review of the *Trade Practices Act* in 2003 concluded that the introduction of such a power was not necessary;

2. the ACCC commented as recently as July 2008 that creeping acquisitions:*". . . are not currently an issue in the grocery industry"*; and

3. in its recent report into the competitiveness of retail prices for standard groceries ('Grocery Inquiry Report'), the ACCC found that a cumulative assessment of recent acquisitions in the grocery industry: *"… has not been a significant contributor to any competition problems in the supermarket sector in recent years"*.

Section 50 of the *Trade Practices Act* already prohibits mergers or acquisitions which have the effect or likely effect of substantially lessening competition in any market. This mergers test already permits consideration of a very wide range of factors which may be relevant to this assessment, including the extent to which substitutes are available, the dynamic characteristics of the market, and the likelihood that the acquisition would result in the removal of a vigorous competitor.

The ACCC also considers that section 50 of the *Trade Practices Act* extends to the entry into or acquisition of a lease, an option to acquire land, or the acquisition of freehold land, and on this view, the current mergers test is already capable of applying to the acquisition of both existing businesses and greenfield sites.

Given these already wide powers, it is unclear why the existing mergers test would not enable the ACCC to oppose any acquisition, no matter how small, if it raised genuine risks to the competitive process. In this regard, the recent ACCC decision in relation to Woolworths' proposed acquisition at Karabar clearly demonstrates the ACCC's ability, under the existing law, to oppose and prevent the acquisition of even a single store if the acquisition would substantially lessen competition.

On this basis, Coles considers that there is no current need for any change to the current mergers test.

The proposed models

Coles has serious concerns about each of the proposed models, but particularly in relation to the proposed "substantial market power model" which appears to be unique in modern economies and is put forward without supporting economic justification for such a radical change to established merger control laws.

The Discussion Paper canvasses the two proposed models at only a very high level and, as a result, does not permit a detailed consideration and response to the proposals. The Discussion Paper does not purport to address the many complexities which are raised by the proposals and the difficulties associated with the implementation of those models. For example, it does not address or provide any details in relation to:

- in the case of the "aggregation model", how long the "look back" period would be, how the "look back" period would be applied in practice, and how the aggregation would work for acquisitions in different geographic or product markets;

- in the case of the "substantial market power model", what materiality threshold (if any) would apply to the assessment of whether or not a corporation has a "substantial degree of market power" and the assessment of whether or not an acquisition would be likely to "lessen competition"; and

- in relation to either proposed model, the likely impact on the ACCC's existing merger processes – for example, the potential impact of any increase in applications for merger authorisations.

Accordingly, the below analysis of the proposals is undertaken at only a very high policy level. Our comments are specifically provided in relation to the industry in which we operate, but could be applied to the broader commercial environment.

The "aggregation model"

Coles considers that the proposed "aggregation model" is likely to create significant uncertainty and risks to investment because, at a practical level, it is extremely unclear how the proposed test would or should be applied to any particular transaction.

It is unclear how the current mergers test, which involves a forward-looking test (that is a comparison of the likely state of competition in the relevant market "with and without" the acquisition), should be applied to acquisitions that have already occurred. In effect, the test would require the ACCC (and businesses) to "look back" and hypothesise as to the impact of acquisitions which were completed a number of years ago, as if they did not happen, in order

to determine whether or not the absence of those acquisitions would, when taken with the current acquisition, substantially lessen competition in the future. This is obviously capable of generating substantial uncertainty and is highly impractical for businesses to apply.

The model can also be criticised on the basis that any "look back" period is likely to be arbitrary (and as yet to be determined), and market boundaries and competitive dynamics may have changed during the "look back" period.

It is also unclear what the proposed "aggregation model" adds to the current mergers test in section 50 of the *Trade Practices Act*.

To be effective, the "aggregation model" would require substantial clarification and refining to address each of the issues, and procedural concerns, outlined above.

The "substantial market power model"

Coles also considers that the "substantial market power model" is highly problematic.

The proposed model introduces a new threshold for opposing acquisitions which has no other parallel in the *Trade Practices Act* and does not, to the best of our knowledge, exist in any other major jurisdiction with developed competition laws.

The proposed model requires two assessments – first, whether the acquirer has a "substantial degree of market power" and, second, whether the acquisition would "lessen" (as distinct from "substantially lessen") competition in any market. It is unclear, and yet to be determined, what the exact scope of each of these terms is.

There is a very real risk that the proposed "substantial market power model" will prevent businesses right across the Australian economy that might be viewed as having market power from considering or proceeding with any acquisitions, as it may, in many cases, be impossible for them to be certain that the proposed acquisition may not have some effect on competition (albeit not substantial, material or more than transitory). As a result, it may have the undesirable effect of preventing businesses from entering geographic locations to offer more choice and lower prices, and instead protect less efficient and higher price competitors. In this sense, the "substantial market power model" may operate as a de facto market share cap and limit larger companies to organic growth.

Unintended adverse effects

There is a real risk that implementation of either of the models proposed in the Discussion Paper will be detrimental to competition, consumers and small businesses.

Firstly, the proposed models, if implemented, may limit the ability of existing store owners (particularly small business owners) to sell their business to potentially interested purchasers. The "substantial market power model", in particular, could have the effect that only smaller, and arguably less efficient and higher price stores would be able to acquire additional stores, leases or land. It would obviously be a poor result if the proposed changes actually reduced the competitive tension in the market for the sale of those businesses, raised barriers to exit and reduced the value of independent businesses to business owners. This is especially the case for many small business owners, where their business is their superannuation –and

materially decreasing the value of their business by limiting competition and the available market for sale would be a very unfortunate consequence.

Secondly, businesses faced with the uncertain application of either of the models proposed in the Discussion Paper, may simply choose not to pursue certain acquisition opportunities in circumstances where the acquisition may otherwise have provided substantial benefits to consumers – either through lower prices available through economies of scale and/or choice of products. Again, it would be a poor result if the proposed changes had the unintended effect of the lessening the choices available for consumers, or prevented them from benefiting from lower prices generated by efficiencies and scale.

Given the absence of any demonstrated need for change, the proposed changes will also unnecessarily increase regulatory and administrative burden on the ACCC and commercial enterprise.

Conclusion

Coles considers that there is no demonstrated need for any changes to the *Trade Practices Act* to introduce a "creeping acquisitions" power.

Although the current Discussion Paper arises out of the Grocery Inquiry Report, the proposals contained in it will have a far-reaching impact across all industries in Australia, not limited to just the grocery industry. The introduction of either of the models proposed in the Discussion Paper is likely to create very substantial business uncertainty and raises a very real risk of significant unintended consequences for industries right across the Australian economy and therefore, ultimately, consumers.

Coles strongly urges The Treasury to consider further what is driving the calls for reform and whether those calls are genuinely motivated by a desire to protect competition and deliver the best outcomes for consumers. Coles also urges The Treasury to be mindful of the unintended consequences and substantial harm which can result from unnecessary and imprecise tinkering with regulatory provisions.

Coles remains convinced that the proposed models for amending the mergers test in the *Trade Practices Act* do not represent good competition or regulatory policy. If, however, the Government considers it necessary to introduce some form of prohibition on "creeping acquisitions", Coles submits that the "aggregation model" is to be preferred over the "substantial market power model". We would, however, strongly urge The Treasury to consider further the difficulties with the proposed model outlined in this letter.

We thank you for the opportunity to submit our comments in relation to the Discussion Paper. We trust that you will consider our concerns and seek open discussions with you about the issues of mergers and acquisitions.

Yours sincerely

Chris Mara
Adviser, Government Affairs