12 June 2009

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To the General Manager

Creeping Acquisitions Discussion Paper

Coles notes the Creeping Acquisitions Discussion Paper issued by Treasury on 6 May 2009 (**Discussion Paper**) and welcomes the opportunity to provide comments.

Coles believes that the problems of so called '*creeping acquisitions*' can be addressed under the current regulatory regime and the proposed changes in the Discussion Paper may have unintended consequences that will outweigh any benefit that may be achieved.

The 'problem' of creeping acquisitions

The term 'creeping acquisition' has long been understood to refer to a corporation undertaking a series of small acquisitions that individually would not substantially lessen competition in a market, but collectively may have this effect over time. The concern has been that the current test contained in section 50 of the Trade Practices Act may not adequately capture these acquisitions, as the effect on competition is an aggregate effect over time, as opposed to manifesting itself in any of the individual acquisitions themselves.

Coles does not believe there is either a demonstrable need for change or a compelling case for change. The only examples that have been given of creeping acquisitions in the Discussion Paper re hypothetical in nature. There are no actual examples of acquisitions that were not caught by the test in Section 50 individually, but that should have been caught on an aggregate basis.

Coles' concerns in this regard are supported by a number of the other submissions made to Treasury in response to the previous discussion paper in 2008. For example, the Law Council of Australia, questioned whether there was really a problem or need for reform in this area of the Act and concluded that:

> *'There are no practical examples of the alleged problems and no overseas examples of the proposed solution.'*[1]

The Law Council went on to say:

> *'…support for "creeping acquisition" reform has consistently been …theoretical or hypothetical…without solid examples to back it up.'*[2]

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[1] Law Council of Australia Trade Practices Committee, *Submission on the Commonwealth Governments Discussion Paper – Creeping Acquisitions October 2008*, p.6.
[2] Ibid p.7.

These concerns have not been addressed in the new Discussion Paper. Instead, the proposed amendments to the Act on page 2 of the Discussion Paper are based on the following:

> *'…where there is evidence of a limitation in the TPA that may be exploited to the detriment of consumers, there is a role for government to resolve this limitation.'*

However, as with the previous Discussion Paper, no evidence of a 'limitation' in the TPA which justifies the proposed solutions has been identified. There remains no empirical evidence to suggest that the existing merger provisions in the Act have been exploited in a manner that has resulted in any detriment to consumers.

The grocery industry is frequently cited as one in which the so-called problem of creeping acquisitions is particularly acute. However, after the most extensive review of the state of competition in the grocery sector ever conducted in Australia, the ACCC concluded that creeping acquisitions in this sector:

> *'…has not been a significant contributor to any competition problems in the supermarket sector in recent years.'*[3]

The ACCC went on to conclude:

> *'Most of the new growth by Major Supermarket Chains (MSC) in recent years has not come from acquisitions of independent supermarkets. No specific evidence has been provided to show that acquisitions of existing businesses have caused significant competitive detriment in the grocery industry in recent years.'*[4]

We believe that the current test under section 50 of the Act is sufficiently flexible to give the ACCC (and the Courts) the ability to take into account a wide range of factors that are relevant to the likely effect of a particular acquisition on competition in a given market. In the grocery sector, this was amply demonstrated in the ACCC's intervention and blocking of such an acquisition in regional NSW (the '*Karabar*' case) in 2008.

In any event, when discussing concerns raised with the ACCC regarding the cumulative effect of individual acquisitions and whether they had been detrimental to competition in grocery retailing, the ACCC concluded that it:

> *'…has not been able to identify any supermarket acquisitions in the last five years where the result would have been different had the ACCC been able to take into account other acquisitions in the same market. This suggests the cumulative effect of a series of acquisitions of independent supermarkets by the MSC's has not been significant contributor to any competition problems in the supermarket sector in recent years.'*[5]

On this basis, Coles considers that there is no current or demonstrated need for any change to the existing mergers test applicable under the Act, whether on a global or industry specific basis.

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[3] *ACCC Report into the Competitiveness of Retail Prices for Standard Groceries July 2008*, p.427.
[4] Ibid p.429.
[5] *ACCC Report into the Competitiveness of Retail Prices for Standard Groceries July 2008*, p.427.

The proposed regulatory options

The options proposed in the Discussion Paper canvass an amended version of the substantial market power model proposed in the first discussion paper. Both options involve a prohibition on a corporation with a substantial degree of market power acquiring shares or assets where that acquisition would enhance that market power (**Amended SMP Model**).

Putting aside the issues of whether there is a problem or need for change, Coles believes that the Amended SMP Model is unlikely to achieve the Government's stated objective of '*getting the balance right between protecting consumers from dangerous anti-competitive acquisitions; and promoting efficient organic growth for business*'[6]. Indeed, the Amended SMP Model risks losing sight of the very problem it is attempting to fix. This is because the Amended SMP Model suffers the very same limitation that the current section 50 test is alleged to suffer - it looks at the effect of a single transaction, rather than the aggregate effect of a series of transactions over time. This effectively means that there is a very real risk that the proposed model will hamper legitimate acquisitions that should not, and were never intended to be, prevented.

The Amended SMP Model

The Amended SMP Model introduces a new threshold for opposing acquisitions which has no precedent in Australia and does not, to the best of our knowledge, exist in any other major jurisdiction with developed competition laws.

This model appears to automatically equate market power with anti-competitive impact and consumer detriment. However, it has been consistently recognised that the mere possession or accrual of market power is not in and of itself enough to warrant regulatory intervention. It is the manner in which that market power is *used* that is critical. Simply possessing market power is not something which is currently prohibited under the Act.

Further, the Amended SMP Model introduces the concept of 'enhancing' a corporation's substantial market power. The term 'enhancing' is not defined and as a result, the scope of this term is unclear and untested. The failure to include a qualitative element to the proposed test means that the actual level, degree or effect of any 'enhancing' would be an immaterial consideration. It is therefore entirely probable that *any* acquisition by a corporation with substantial market power runs the risk of being considered to enhance that corporation's market power and effectively cap their market share.

In addition, the Discussion Paper clearly acknowledges on page 4 that any intervention in this area '*should not stop the legitimate and organic growth of businesses that is designed to increase production efficiencies to enhance the welfare of Australians*' and that this is '*particularly important in the current economic environment*'. However, an acquisition that provides production efficiencies may very well be caught by the proposed changes, as that acquisition may also 'enhance' the market power of the acquirer.

As a result, Coles considers that the Amended SMP Model may create significant uncertainty for businesses contemplating acquisitions or expansion. This uncertainty may have a very negative effect on future acquisitions or expansion by many businesses, particularly given the concentrated nature of many industry sectors in Australia.

[6] Assistant Treasurer, Minister for Competition Policy & Consumer Affairs, Press Release, *'Creeping Acquisitions - The Way Forward'*, No. 035.

Prohibiting the accrual of market power is not in line with the policy objectives of the Act

As noted above, the Amended SMP Model appears to automatically equate market power with anti-competitive impact and consumer detriment. This is not consistent with the existing policy framework of the Act.

Section 2 of the Act provides that:

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

The possession of substantial market power, or its 'enhancement' does not, in and of itself, reduce competition in a market to the detriment of Australians. On the contrary, acquisitions that 'enhance' market power may also enhance the welfare of Australians by way of increased savings as a result of economies of scale, increased efficiency, innovation and a greater ability to compete against larger domestic competitors or even on a global scale. Acquisitions which lead to an enhancement of market power may be a result of natural attrition in a market resulting from other 'non-competition' related issues, such as corporate governance in relation to some recent high profile matters.

Coles notes that, once substantial market power is acquired, section 46 of the Act already prohibits the *misuse* of such power for an anti-competitive purpose. Accordingly, concerns flowing from the possession of market power are dealt within under the existing provisions of the Act.

The Amended SMP Model may restrict growth, particularly organic growth

The acquisition of an asset has been defined very broadly and may include the acquisition of plant and machinery, the acquisition of a 'greenfield' site and entering into or renewing a lease, in addition to the acquisition of a business.

Coles is concerned that the Amended SMP Model, combined with the broad interpretation of an 'asset' under the Act, may prohibit future growth of a corporation which has substantial market power.

The problem of adopting a model based on substantial market power was recognised by the Law Council, in its comments on the previous discussion paper[7]. The Council said such a model is too restrictive because:

> *'…by prohibiting any acquisition by a firm that has substantial market power that would result in any lessening of competition in the same market, is likely to have a major chilling effect on future acquisitions, including acquisitions which, on any analysis, are highly unlikely to be of real anti-competitive concern.*[8]

The Council went on to say that there is a real danger in introducing a standard of any lessening of competition for firms with large market shares as it:

> *'…may come close to an absolute prohibition on any acquisition by these firms in the relevant market.*[9]

[7] Law Council of Australia Trade Practices Committee, *Submission on the Commonwealth Governments Discussion Paper – Creeping Acquisitions October 2008*, p.16.
[8] Ibid p.16.
[9] Ibid p.17.

The Law Council concluded that the substantial market power model would therefore:

> *'…prevent particular acquisitions, even where any increase in the acquirers market power will be insignificant or transitory. In such circumstances, it is clear that the application of this model will not deliver any benefits for consumers or any efficiency improvements in the economy.'*[10]

The Amended SMP Model proposed in the Discussion Paper raises similar concerns to the previous model proposed in 2008. Because the concept of 'enhancing' is not qualified with any materiality threshold, there is a real risk that virtually all acquisitions by corporations with market power would be caught.

Further, the Amended SMP Model does not allow for the possibility of there being acquisitions by corporations with substantial market power that may enhance that corporation's market power but still have a pro-competitive outcome. An example is the acquisition by a corporation with market power of a new unique technology that produces efficiency benefits and, in turn, lowers prices for consumers. Such an acquisition could arguably 'enhance' the corporation's market power for a period of time, but could equally encourage competitors to pursue similar efficiency gains or invest in innovations that enable them to compete more effectively. The proposed model would not allow these matters to be taken into account, but would prohibit the initial acquisition without consideration of the flow-on beneficial impacts.

Such a model would also in effect place a cap on the market shares of firms with substantial market power. The 2003 Dawson Trade Practices Committee Review rejected proposals to cap a firms market share because such caps would:

> *'…stifle competition and protect the unsustainable position of inefficient competitors'*[11].

This may have the effect of prohibiting both anti-competitive and pro-competitive acquisitions. For example, the Amended SMP Model may prevent:

- major airlines from acquiring new planes and therefore offering increased services on an existing route or services on a new route;
- major resource companies from acquiring land on which to open new mines; and
- major retailers from renewing an existing lease.

Similarly, the Amended SMP Model may prohibit a corporation from entering into a lease over, or purchasing, land in a local area in which it does not currently have a presence in circumstances in which it could be argued that the acquisition enhances market power that exists on a national level. This could have the unintended effect of actually *reducing* competition (to the detriment of consumers) in that local market.

The potentially broad application of the Amended SMP Model is concerning in highly concentrated Australian markets. In markets where there are only a small number of market participants, it is possible that most or even all market participants have substantial market power. The Amended SMP Model could effectively prohibit any merger or acquisition by all corporations in these markets. In turn, this may have the unintended consequence of stifling innovation (as corporations could be prohibited from acquiring new technology or product solutions) and, as a consequence, future competition in those markets.

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[10] Ibid p.17.

[11] *Review of the Competition Provisions of the Trade Practices Act 2003,* p.67.

Finally, Coles is concerned about the possible unintended consequence of prohibiting these types of acquisitions for other related industries. An example is the impact on the commercial property sector of a prohibition that could stifle the growth of major retailers.

As noted by the ACCC in its Grocery Report:

> *'… information obtained during the inquiry show that acquisitions of existing retail grocery businesses over the past 15 years have to some extent contributed to the growth of MSCs. However, the main source of growth has occurred through the development of new retail sites…an overwhelming proportion of new growth for MSCs over the last five years has come from the development of new sites. This preference of the MSCs for the development of new sites is even more pronounced over the last two years, accounting for 90 per cent of store openings.'*[12]

If the Amended SMP Proposal prevents major retailers, whether in the grocery sector or otherwise, from acquiring new sites, entering into new leases or even renewing existing leases, this will effectively remove potential bidders from the competitive process for site acquisitions and lease arrangements and will have a significant impact on the ability of commercial property owners to lease these sites and command appropriate rents. In some cases, the absence of an appropriate "*anchor tenant*" may prevent a commercial project from proceeding at all.

The result would be less investment and development in new amenities and infrastructure that benefits the community, the economy and creates jobs.

In addition, removal of potential bidders from the competitive process has the real potential to diminish the value of the relevant land holdings if the rental income able to be derived from these holdings is reduced as a result of the reduction in the number of available tenants. In other words, the Amended SMP Proposal may not only stop a development project from proceeding, it could then also materially decrease the value of the land on which the project was intended to proceed.

For these reasons Coles considers that there is a risk that implementation of the Amended SMP Model, will be detrimental to both competition and consumers in Australia as it appears aimed at protecting particular competitors, rather than competition as a whole.

The Amended SMP Model will have unintended consequences for small businesses

The Amended SMP Model would also limit the ability of small business owners to sell their business. If any corporation with substantial market power is prohibited from acquiring the shares or assets of small businesses, the pool of potential acquirers for the sale of these businesses will be severely curtailed. The outcome of this course of action may well be a reduction in the value of their businesses. For many small business operators, their business holdings are in effect their 'superannuation' as it is their only substantial asset. Accordingly, the Amended SMP Model risks increasing the barriers to exit and having an adverse effect on the succession planning of small business owners.

Additional issues in the declaration model

The Government has proposed a further model in the Discussion Paper, under which the Amended SMP Model would only apply to a 'declared' corporation or corporations in declared product or service sectors.

[12] *ACCC Report into the Competitiveness of Retail Prices for Standard Groceries July 2008*, p.533.

Coles believes that introducing a power to declare individual corporations for the purposes of merger control is inappropriate. The model, in effect, allows the Minister to single out particular industries or corporations and make them subject to a two-fold mergers test (being the current section 50 and the proposed new section). This involves a practical risk of:

(a) where a corporation is declared, increasing compliance costs for that corporation compared to its competitors (for example, the cost involved in determining whether an acquisition complies with the additional mergers test and of seeking any required clearances) making it more difficult for that corporation to effectively compete;

(b) where a sector or industry is declared:

- creating adverse publicity for the corporations affected in circumstances where they have not engaged in any wrongdoing;
- requiring even small participants in an industry to apply the additional mergers test;
- imposing the additional compliance costs referred to above; and

(c) without clear parameters and limits around the declaration process, entire sectors of the economy being subjected to regulatory and public scrutiny according to the political agenda of the day.

The proposed power for the Minister to set mandatory notification thresholds for acquisitions by declared corporations or by corporations in declared product/service sectors may be a more straightforward way of addressing areas of political importance, however, this is likely to be subject to regulatory bracket creep and may also create unnecessary administrative and regulatory hurdles and delay. This may increase compliance costs for business and the ACCC.

Conclusion

The Government is committed to a best-practice regulatory reform model that seeks to pursue and develop new regulation only if regulatory failure has been clearly identified and defined and it has been clearly demonstrated that existing regulation or legislation cannot remedy the failure.

On this basis, the proposed changes do not meet these basic tests and, Coles believes, the Amended SMP Model fails the tests of good public policy, namely; simplicity, neutrality, fairness and low cost.

The fundamental issue that Coles believes needs to be addressed is a clear policy statement of what the proposed creeping acquisition reforms are trying to achieve.

Coles also suggests that the Productivity Commission review these proposals to ensure a through cost-benefit analysis is completed before any changes are made.

We thank you for the opportunity to submit our comments in relation to the Discussion Paper.

Yours sincerely

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