10 July 2009

The General Manager
Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir or Madam

Treasury's Proposal to Regulate Creeping Acquisitions

Thank you for providing this opportunity to present our views on the proposed new merger laws. The views expressed in this submission are those of the authors. They do not represent the views of Johnson Winter & Slattery or any of its clients.

1 Executive summary

1.1 Mergers play a key role in promoting economic efficiency. A merger is a market mechanism that promotes the production of the goods or services most valued by consumers at a lower cost. It is also a mechanism to replace inefficient management boards. Mergers unlock synergies and promote efficiencies to the benefit of corporations small and large, to the ultimate benefit of consumers. In this context, any proposed new merger law must be justifiable as both necessary and able to deliver economic benefits that outweigh any associated public detriments.

1.2 To date, no evidence has been presented and no economic or legal argument has been articulated on the economic detriments of creeping acquisitions that are not addressed by the existing section 50 of the *Trade Practices Act 1974* ('TPA'). The ACCC's Grocery Inquiry[1] did not provide any evidence of economic harm from creeping acquisitions in grocery retailing. Similarly, the ACCC's concerns regarding frequent acquisitions in industries such as taxis, liquor stores, pathology services, waste services, childcare, optical dispensing, packaging and funeral services[2] are not supported by any industry reports. There is a real risk that Treasury is proposing to introduce a new merger law for Australia without a reasonable mandate.

1.3 Australia is a small economy with many concentrated industries. Market power can exist in markets that fall well short of a monopoly market structure. Treasury's proposed merger law targeting corporations with substantial market power may mean that a large number of merger transactions will be scrutinised under the new test.

---

[1] Australian Competition and Consumer Commission, *Report of the ACCC Inquiry into the Competitiveness of Retail Prices for Standard Groceries*, July 2008 ('Grocery Inquiry').
[2] *ACCC Submission to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs Regarding Creeping Acquisitions*, October 2008 at [20].

Level 30, 264 George Street
SYDNEY NSW 2000
Telephone: +61 2 8274 9555 ■ Facsimile: +61 2 8274 9500

www.jws.com.au

SYDNEY ■ MELBOURNE ■ ADELAIDE ■ PERTH

1.4 Treasury's two proposals utilise the same substantive test; whether the proposed acquisition by a corporation with a substantial degree of market power enhances that market power ('the enhancement test'). There is considerable uncertainty as to how the term 'enhancing' should be interpreted.

1.5 If a narrow interpretation is given to 'enhancing' to capture small scale acquisitions, the enhancement test would prohibit any acquisition by a firm with substantial market power. The adverse consequences of a narrow interpretation is the prohibition of acquisitions that are either pro-competitive or have a neutral effect on competition.

1.6 If a broader interpretation of 'enhancing' is adopted, the enhancement test would have a similar impact as the existing section 50 test. Treasury's 'problem' of piecemeal small scale acquisitions does not find a remedy with a broader interpretation.

1.7 If the enhancement test is not abandoned, it could considerably damage Australia's merger laws. To capture piecemeal acquisitions, the enhancement test requires a short term weak competition analysis. The enhancement test is a heavy handed regulatory approach that finds no precedent in section 46 of the TPA.

1.8 The declaration model (Treasury's second proposal) places an arbitrary and discriminatory cap on the ability of declared corporations to grow by acquisitions as the enhancement test may potentially prohibit any acquisition. This model should not be adopted.

1.9 The commercial costs and risks of Treasury's two proposals includes, restricted choice of buyers available to small business seeking to exit the market; increased deal costs; increased regulatory risks from a public finding of substantial market power; increased gaming by competitors, customers and suppliers; and most seriously, an inhibition on management to make legitimate commercial decisions.

1.10 The way forward for creeping acquisitions reform should involve more considered analysis of the economic detriments associated with creeping acquisitions (on suppliers and customers) and whether the economic detriments are not adequately captured by the operation of the current section 50. No new merger law should be introduced in the absence of such an analysis.

2 The 'problem' of creeping acquisitions and section 50 analysis

2.1 Treasury's concern that section 50 does not address the economic harm of creeping acquisitions requires close scrutiny. Treasury has framed its concern as:

> 'Creeping acquisitions refer to the acquisition of a number of individual assets or businesses over time that may collectively raise competition concerns, but when considered in isolation, are unlikely to be captured by the existing mergers and acquisitions test under section 50…'[3]

2.2 This 'problem' was outlined in more detail by the Senate Economics References Committee ('SERC')[4] in the following example: a major chain buying 100 stores in one go which would result in a substantial lessening of competition and the same major chain buying the same 100 stores over a period of years, piecemeal and one by

[3] The Hon Chris Bowen MP, Assistant Treasurer Minister for Competition Policy and Consumer Affairs, Media Release, *Creeping Acquisitions – the Way Forward*, 6 May 2009.
[4] The Senate, Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in Protecting Small Business*, March 2004, p 61.

one. In the latter case, it would be difficult to find that each acquisition on its own represents a substantial lessening of competition.[5]

2.3 Treasury has also framed the 'problem' of creeping acquisitions as:

> 'In practice, concerns typically arise where a supplier with substantial degree of power in a market acquires small competitors.'[6]

2.4 This second 'problem' of creeping acquisitions focuses on preventing corporations with substantial market power from acquiring smaller competitors.

Section 50's answer to piecemeal acquisitions

2.5 The substantial lessening of competition test in section 50 does provide an answer to SERC's example of piecemeal acquisitions. In the spectrum of small scale acquisitions (where the acquirer's market share is continuously but incrementally increased by 1%), section 50 identifies a tipping point where one further acquisition would mean there are insufficient competition constraints remaining on the merged entity and the merged entity could profitably raise prices or restrict output. It is at this tipping point that section 50 would prohibit the merger. To block a merger prior to there being a meaningful impact on the competitive process would hinder legitimate market forces from determining allocative and productive efficiency.

2.6 The substantial lessening of competition standard is not an absolute test but is relative to the competition process *in a market.*[7] Section 50 is not solely concerned with whether the change in market share is 1% or more (as set out in SERC's example above); rather it considers the changes to the competition constraints in *the relevant market*. The High Court in *Rural Press Limited* noted:

> 'The relevant questions in this case are whether the effect of the arrangement was substantial in the sense of being meaningful or relevant to the competitive process.'[8]

Section 50's answer to substantial market power

2.7 Market power is the antithesis of competition in the sense of a corporation having some ability to act unconstrained by competitive forces. In theory, the test 'whether an acquisition would result in a substantial lessening of competition' may often be the mirror of 'whether the merged entity would gain a substantial degree of market power'.

2.8 Section 50 prohibits a merger where pre-acquisition a corporation does not have substantial market power but post-acquisition would have substantial market power.

2.9 Where a corporation already has a substantial degree of market power and proposes to make a small scale acquisition, section 50 prohibits the merger if post-acquisition, the merged entity could exercise greater buyer power (require suppliers to provide

---

[5] *Ibid* p 60 at [4.51]. The same 'problem' of creeping acquisitions is set out in Dawson Committee, *Review of the Competition Provisions of the Trade Practices Act*, Canberra, January 2003 p 66 and Report by the Joint Select Committee on the Retailing Sector (the Baird Committee), *Fair Market or Market Failure? A Review of Australia's Retailing Sector*, Parliament of the Commonwealth of Australia, Canberra 1999 at [5.32-5.33].

[6] The Hon Chris Bowen MP, Assistant Treasurer Minister for Competition Policy and Consumer Affairs, First Discussion Paper, *Creeping Acquisitions – Discussion Paper*, 1 September 2008 at [18].

[7] See subsection 50(3) factors for assessing a substantial lessening of competition and subsection 46(3) for assessing market power.

[8] *Rural Press Limited v Australian Competition and Consumer Commission* as per Gummow, Hayne and Heydon JJ (2003) HCA 75 at [41].

lower prices or more favourable non-price terms of supply) or supplier power (supply less or charge more to customers). Where there are concerns that consumers are likely to face significantly higher prices (5-10% price increase) or reduction in quality/choice of products[9] as a result of the merger, section 50 prevents the merger.

2.10 Any piecemeal acquisition by a corporation that has substantial market power may be prevented by section 50 if, for example, it would result in the loss of a vigorous and effective competitor,[10] raise barriers to entry (such as economies of scale and sunk costs),[11] increase vertical integration,[12] or strengthen network effects through control of key assets or dynamic characteristics of the market.[13] Section 50 provides a high degree of flexibility through its non-exhaustive factors to consider competition concerns. The ACCC has not stated that these tools (either individually or together) are inadequate in dealing with mergers where the acquirer has a substantial degree of market power and its published reasons in blocking mergers appear to support the contrary.

ACCC's findings in the Grocery Inquiry

2.11 The Grocery Inquiry provided an opportunity to identify potential economic harm from creeping acquisitions – whether it is increased buyer power or supplier power. There was little evidence provided to the Grocery Inquiry concerning the buying power of Woolworths and Coles' possibly due to the fear of retribution.[14] In relation to supplier power, the ACCC found the grocery retail markets to be workably competitive.[15] The ACCC findings in the grocery sector were that creeping acquisitions did not appear to be a significant current concern in the grocery retail markets as "[m]ost of the new growth by MSCs (Major Supermarket Chains) in recent years has not come from the acquisitions of independent supermarkets."[16] The Grocery Inquiry did not identify what, if any, are the economic detriments of creeping acquisitions.

2.12 Perhaps the strongest evidence that section 50 is effective in dealing with creeping acquisitions also comes from the ACCC's Grocery Inquiry which reported:

[9] For example, the ACCC's decision to block Australian Pharmaceutical Industries Ltd's proposed acquisition of Sigma Co Ltd, Authorisation No A30215 (11 September 2002). The ACCC was concerned the reduction of full-line wholesalers from 3 to 2 would result in a reduction in the quality of service provided to pharmacies and subsequently, to consumers.

[10] For example, the ACCC's decision in Patrick/FCL (Public Competition Assessment, 12 May 2006). FCL was the second largest national freight forwarder whilst Patrick was only a small operator in the freight forwarding space, but the acquisition was characterised as a vertical merger and blocked on the basis that independent freight forwarding companies would find it more difficult to compete with the integrated merged entity. The ACCC was also of the view that there would be a decrease in the likelihood of vigorous competition between Toll and Patrick/FCL post-acquisition.

[11] For example, the ACCC's decision to block Bristle Holdings Limited's proposed acquisition of Pioneer Building Products Pty Ltd [1997] ATPR (Com) 50-250. The ACCC had denied authorisation on the basis that Bristle was the only manufacturer of clay roof tiles in Western Australia and to allow the acquisition would further raise barriers to entry.

[12] Note 10 *ibid*.

[13] For example the ACCC's decision in Coca-Cola Amatil Ltd's ('CCA') proposed acquisition of Berri Limited (19 November 2003). CCA had substantial market power for carbonated soft drinks but less than 1% of the market for fruit beverages. The merger was blocked on the basis of network effects and weak dynamic characteristics in the market.

[14] Note 1 *ibid* p 357.

[15] *Ibid* p 212.

[16] *Ibid* p 429.

> 'The ACCC 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.'[17] (Our emphasis)

2.13 The ACCC's statement reflects that even in the highly concentrated grocery sector, a law specifically dealing with creeping acquisitions would not have resulted in different merger outcomes relative to what was decided under section 50. Consistent with the ACCC's statement, we also note the Treasury's comments that:

> 'The Government continues to be committed to the existing section 50, and considers that it is functioning well in the majority of mergers and acquisitions cases.'[18]

2.14 For the above reasons, we are strongly of the view that no separate or unique economic detriments from creeping acquisitions have been identified. Section 50 has not been demonstrated to be inadequate in addressing competition concerns arising from all mergers and acquisitions.

3 New enhancement test – problems & risks

3.1 We are strongly of the view that there is no need to introduce a reform for 'creeping acquisitions'. However, as Treasury has requested submissions on the proposed declaration and general prohibition models, these are examined below. Irrespective of which model is considered, the substantive test in the two proposals is the same enhancement test. This is considered first.

3.2 The enhancement test, like the substantial lessening of competition test, is an analysis of the change in market power over a temporal dimension from a single acquisition. However, the rigour and strength of the legal and economic analysis in the two tests are very different. Introducing an additional, weaker merger test has the potential to damage Australia's merger laws.

Interpretation of 'enhancing'

3.3 The term 'enhancing' has not been previously considered in Part IV of the TPA. The Macquarie Dictionary definition of 'enhance' is 'to raise to a higher degree; intensify or to magnify'. The Oxford English Dictionary definition of 'enhance' is 'increase the quality or power of'. 'Enhance' does not contain any direction on the significance of the change in competition in a market. It is an inappropriately low threshold for testing mergers as all mergers, to varying degrees, could be said to enhance the acquirer's market power.

3.4 If 'enhancing' is interpreted narrowly to mean any increase, regardless of the increase being negligible or small, the enhancement test would prohibit any firm with substantial market power from engaging in **any** merger or acquisition transaction. This prohibition would apply even if the transaction has no anti-competitive effects under section 50. A narrow interpretation would be consistent with Treasury's intention to capture small scale acquisitions. It may not be possible to prove from an evidentiary view that a single small scale acquisition has the effect of increasing the acquirer's buying power (acquire for less or on more favourable terms from supplier) or supplier power (restricting output or increasing prices to consumers) if 'enhancing' was not interpreted to mean any increase.

---

[17] *Ibid* p 429.
[18] The Hon Chris Bowen MP, Assistant Treasurer Minister for Competition Policy and Consumer Affairs, Second Discussion Paper, *Creeping Acquisitions - The Way Forward*, 6 May 2009, p 3.

3.5 If a broader interpretation of ‘enhancing’ is adopted, the enhancement test would have a similar impact as the existing section 50 test. It would assess whether in the foreseeable future, the small scale acquisition would result in the acquirer being able to exercise greater buyer power or supplier power. Treasury’s ‘problem’ of piecemeal small scale acquisitions by a firm with substantial market power would not find a remedy with this broad interpretation of ‘enhancing’.

Pro-competitive mergers will be prohibited

3.6 Implicit in Treasury’s discussion paper and proposals is an assumption that all firms with market power engaging in small scale acquisitions cause competitive harm. There are many pro-competitive and efficiency enhancing reasons why a firm with market power may seek to acquire smaller competitors; and should not be hindered from doing so. Whilst it may be possible to seek authorisation for a merger under the enhancement test, the time and costs involved in the authorisation process may not mitigate the chilling effect of the enhancement test.

3.7 For example, firms in mature or declining industries would not be able to grow organically (growth from an expansion of output or sales) to take advantage of economies of scale. In certain industries, especially with the current decline in the economy and the global credit crunch, large incumbents face consolidation and rationalisation in the same way that smaller competitors do. Mergers and acquisitions that allow incumbents to gain scale economies are generally beneficial to consumers as this leads to lower consumer prices. The enhancement test, in these circumstances, potentially hurts consumers who would otherwise benefit from the merged entity’s lower marginal costs.

3.8 Firms with substantial market power may also engage in mergers and acquisitions to take advantage of short windows of opportunity to grow or diversify into other markets. Organic growth (a greenfield operation) is not a viable option for these short windows of opportunity as organic growth requires time and risks. For example, where there is a removal of a regulatory entry barrier, firms with substantial market power may seek to merge in the same or related markets to gain a competitive advantage over rivals (including international competitors) by entering the market quickly. This is pro-competitive as competition by its very nature is ruthless and injurious to competitors. The enhancement test would in these circumstances hinder a large firm from positioning itself to take advantage of new opportunities and compete effectively.

Relevant temporal dimension for the enhancement test

3.9 A proper assessment of competition and competitive effects requires a long term analysis. This is a settled legal and economic principle in Part IV of the TPA. However, a key weakness of the enhancement test is its direction to take a short term competition analysis. As Treasury’s objective is to capture small scale acquisitions as the measure to prevent creeping acquisitions, this dictates or requires a short or immediate temporal dimension to achieve this objective. Acquisitions of one or more small firms may have nil or negligible effect on market power over a period of two years. Over a medium or longer dynamic time horizon, actual and potential competitors will respond to changes in market conditions and the merged entity’s market power may be eroded.

3.10 The ACCC Merger Guidelines state that section 50 focuses on the foreseeable future (generally within one or two years) in considering the market definition and each of the merger factors, such as barriers to entry, competitors and vertical relationships of a market. In certain merger transactions, an even longer temporal dimension may be applicable. For example, in the ACCC analysis of BHP Billiton and Rio Tinto (October 2008) the long term analysis was up to ten years due to the nature of the large infrastructure projects under scrutiny.

3.11 In *Re Qantas Airways Limited*[19], the Tribunal noted:

> 'Competition is a long-run phenomenon, a process whose ultimate benefits may not always be immediately apparent.'[20]
>
> 'It is barriers to entry and expansion that confer(s) the ability to exercise market power… in the absence of barriers to entry and expansion, the applicants' combined market share may be transient.'[21]

3.12 In the *AGL* case,[22] a major retailer of electricity and gas in the national electricity market sought a declaration that its proposed acquisition of a 35% interest in Loy Yang Power, a major generator of electricity in Victoria, would be unlikely to have the effect of substantially lessening competition. The ACCC argued that Loy Yang's deliberate strategy of increasing spot prices (half-hourly price spikes) in response to supply/demand imbalance was an exercise of market power. The Federal Court disagreed and found that over a longer term barriers to entry were low as demonstrated by the response of potential entrants to pricing signals. Justice French noted the high spot prices were not "a long run phenomenon…It does not amount to an ongoing ability to price without constraint from competition."[23]

3.13 What is lost in the enhancement test is the long term competition analysis, in particular the erosion of market power over the long term. By taking a short term analysis of the market, undue weight is given to transient factors, such as, market share and Herfindahl-Hirschman Index[24] calculations, as some evidence of some increase in market power.

3.14 If a long term analysis is undertaken under the enhancement test, the test would be more consistent with section 50 but would not address Treasury's objective of stopping piecemeal acquisitions.

Change in substantial market power

3.15 The starting point of the enhancement test poses difficulties. How would the merger parties or the ACCC seek to distinguish whether the acquirer has some degree of market power or 'substantial' degree of market power? Does any level of pricing above marginal costs (assuming there is any evidence of marginal costs) demonstrate some degree of market power or 'substantial' market power? This is a very difficult distinction to make and under the new enhancement test and its shorter temporal dimension, this distinction will be even more critical and hotly debated.

3.16 Treasury's intentions that small scale acquisitions are to be addressed through the enhancement test again dictates that little or minimal attention be given to the post-acquisition competition analysis. Currently, the section 50 analysis is a comparison of

[19] (2004) ACompT 9 (12 October 2004).
[20] *Ibid* at [421].
[21] *Ibid* at [435].
[22] *Australian Gas Light Company (ACN 052 167 405) v Australian Competition & Consumer Commission (No. 3)* [2003] FCA 1525 (19 December 2003).
[23] *Ibid* at [456].
[24] The ACCC typically measures market concentration with reference to market shares, concentration ratios and the Herfindahl-Hirschman Index (HHI).

the future with the merger and the future without the merger. The enhancement test requires less weight to be given to the future with the merger because without less weight, a single small scale acquisition is unlikely to increase a firm's ability to exercise market power.

3.17 This regulatory approach of a weaker legal and economic analysis when considering the acquisitions undertaken or proposed by a firm with substantial market power is heavy handed. In its Second Discussion Paper, Treasury notes that:

> 'Some submissions noted that the TPA is generally regarded to place greater scrutiny on corporations with existing substantial market power in a market.'[25]

3.18 The precedent relied upon by Treasury and the ACCC in adopting this tough regulatory approach is section 46.

Enhancement test is inconsistent with section 46

3.19 Currently, section 46 targets corporations with substantial market power but it does so with greater safeguards. Section 46(1) is a behavioural prohibition and utilises three tests to determine whether the relevant conduct is illegal. These are:

- a substantial degree of market power;
- conduct that amounts to a 'taking advantage' of that market power; and
- a proscribed anti-competitive purpose.

3.20 In other words, section 46(1) prohibits a corporation that has substantial degree of market power from using that market power, or otherwise taking actions that depend on or are facilitated by that market power, for a proscribed anti-competitive purpose. There is no need for a substantial lessening of competition test in section 46(1) because it is aimed at conduct that uses market power for an anti-competitive purpose. There is nothing in the wording of section 46(1) that characterises the existence of market power alone as 'harmful' or prohibited.

3.21 In contrast to section 46(1), the proposed enhancement test characterises the existence of substantial market power as 'harmful' and weakens the competition analysis of the merger transaction to capture small scale acquisitions. The economic rationale for this regulatory approach is not clear and the approach is not supported by section 46.

3.22 The commercial consequences of a public finding by a Court that a corporation has a substantial market power in section 46 litigation is no different to the ACCC finding the same in an informal merger clearance setting. Both are public statements that contain commercial ramifications. However, in section 46 litigation, access to detailed information on pricing and costs are available, expert economists are called to interpret data and form a view on whether a corporation has a substantial degree of market power. Evidence is tested in an adversarial context. In contrast, in an informal merger clearance setting, neither the merger parties nor the ACCC have access to this information but rather qualitative information is used in assessing subsection 50(3) factors. The risks of getting it wrong are higher in the informal merger clearance context.

3.23 From a regulatory point of view, where corporations with substantial market power are targeted, a strong competition analysis is required to ensure pro-competitive mergers are not hindered. In contrast, the enhancement test appears to weaken the

[25] Note 18 *ibid* at [7]. Treasury refers to the ACCC submission (see note 2 *ibid* p 10) on section 46.

competition analysis to capture small scale acquisitions. This type of heavy handed regulation does not appear to be warranted given Treasury's own view that section 50 is 'functioning well in the majority of mergers and acquisitions cases'.[26]

4 Declaration model

4.1 The declaration model is a step further in regulatory intervention than the general prohibition proposal. It labels specific corporations as having 'substantial market power' or specific sectors of the economy as being 'at risk of creeping acquisitions'. It is unclear what information or criteria would be applied by the Minister in making such a declaration or by the ACCC in making recommendations to the Minister. Currently, before a declaration is made, firms do not have any rights to provide information or engage in discussion on competition issues such as barriers to entry or to assess whether a declaration is appropriate (the declaration is unilaterally made by the Minister). If declared, it is also unclear what rights affected firms would have to appeal such a label. Whilst the declaration may be for a limited period of time, there are no review prospects to take into account market changes and whether the declaration remains appropriate.

Discriminatory cap on growth

4.2 The primary concern with a declaration model is that declared industries or corporations would effectively have a cap placed on their ability to grow through acquisitions, as the enhancement test may prohibit any acquisition. The Dawson Committee Report considered the proposal to have a market cap placed and rejected it as unduly stifling competition and protecting the unsustainable position of inefficient competitors.[27]

4.3 Furthermore, whilst declared industries are assessed under the enhancement test, a similar firm with identical cost structures and market conditions in a non-declared industry would continue to be assessed under the substantial lessening of competition test. This may result in different industries being regulated differently without an economic rationale to justify the different regulatory models.

ACCC's presumption will be to block the merger

4.4 Any declared firm will be approaching the ACCC on a merger transaction will be faced with a strong presumption (express or tacit) that the merger should be blocked. A declaration of market power is likely to influence the ACCC's factual analysis on whether the firm does have a substantial market power. Information presented by parties to the ACCC is also likely to be selectively analysed with a view to confirming the Minister's declaration or the ACCC's own recommendation to the Minister to declare a corporation or industry.

---

[26] Note 18 *ibid* at [13].
[27] Note 5 *ibid* Dawson Committee Report p 67.

5 Commercial implications for both models

5.1 Whether the starting point for creeping acquisition laws is a general prohibition or a declaration model, there are serious commercial implications that arise from both models.

Small businesses exiting from the market

5.2 Laws targeting firms with substantial market power making small scale acquisitions impact on small businesses seeking to exit the market.

5.3 Firstly, the assets of the small business are undervalued if there are restrictions on the choice of buyers available, especially larger buyers. The value of the goodwill associated with a small business may only be maximised by maximising the number of larger bidders. The proposed reforms may result in small business owners losing the value of their goodwill.

5.4 Secondly, any barrier to the exit strategies of small business may discourage entry into the industries where there are currently only one or two large firms, thereby lessening the competitive restraint that small competitors and the threat of new entry has on incumbents.

5.5 Thirdly, the proposed models may present opportunities for gaming. A rival bidder in a tender for a small business acquisition could raise the enhancement test or point to a finding of substantial market power by the ACCC or declaration by the Minister to discredit a higher bid or discourage larger bidders from tendering.

Increased deal costs

5.6 A general prohibition on creeping acquisitions effectively introduces a compulsory notification regime for firms with some market power and may result in an increase in informal merger clearance applications. A general prohibition would mean additional fees for legal and expert economic advice in dealing with the ACCC. These considerations add substantial costs to merger transactions.

Increased regulatory risks

5.7 The proposals increase regulatory risks and the costs associated with the management of those risks. Merger parties face the risk that the ACCC would publicly find one or more of the merger parties to have a substantial degree of market power. This has significant ramifications for corporations as they will be under closer scrutiny under many trade practices provisions, such as, section 46 (misuse of market power) or under sections 51AB or 51AC (unconscionable conduct).

5.8 Declarations of substantial market power by the Minister will have similar ramifications for corporations.

Increased gaming risks

5.9 Competitors may also seek to use the ACCC's findings or the Minister's declaration of substantial degree of market power in tenders and bids for their self-interest. A competitive tender by a firm found to have a substantial degree of market power in a merger transaction may lead to allegations of predatory pricing (section 46) by competitors of that firm.

Two merger tests

5.10 As a matter of regulatory policy, having two tests for mergers is problematic as it opens the door to gaming by rival competitors.

5.11 In non-confidential merger assessments, the ACCC is likely to be faced with the prospect where the merger parties would argue that having passed the substantial lessening of competition test, the merger should be signed off as not raising competition concerns. Spoiler submissions from rival bidders and competitors would argue strongly the acquirer has substantial market power and should be assessed under the enhancement test. This would pose challenges to the ACCC in filtering the responses it receives from market inquiries, responding to spoiler submissions and increase regulatory costs.

Change in management behaviour

5.12 From a business perspective, management may be inhibited by the ACCC's findings or the Minister's declaration of substantial degree of market power in their legitimate commercial decision making. Management decisions concerning product pricing, tenders and bids, commercial negotiations and competitive growth strategies may be impacted by the fear of triggering a host of trade practices issues. The real economic harm to competition and consumers from a law on creeping acquisitions may be the change in management behaviour. Where management are inhibited, the loss is dynamic efficiency of innovation, growth and lower costs.

5.13 The Hon Lindsay Tanner, Minister for Finance and Deregulation, condemned unnecessary regulation:

> 'As well as imposing specific compliance costs, regulation can also have a choking effect on entrepreneurship, risk-taking and innovation.'[28]

5.14 The commercial ramifications identified above are further amplified when considering that more than one business may have substantial market power in a market. A declaration in an industry may therefore impact on more than one large competitor in a market.

6 The way forward

6.1 Section 50 has a variety of flexible tools that allows a thorough analysis of a small scale acquisition. Section 50 has not been proven to be deficit in addressing economic harm in mergers and acquisitions. If there is a case for changing Australia's merger laws, it requires greater articulation and considered analysis then has been put forward to date.

6.2 Treasury may take the approach that supplementing section 50 would nevertheless strengthen Australia's merger laws. However, the reality of the enhancement test is that it weakens merger analysis to capture piecemeal acquisitions. The enhancement test also hinders mergers as a mechanism to unlock productive and dynamic efficiencies and promote competition in industries.

6.3 If there is no clear evidence of an economic harm or legal need for a 'creeping acquisition' law, section 50 should not be inappropriately augmented.

[28] Speech, *Relieving the Burden on Business – Labor's Deregulation Agenda*, Address by The Hon Lindsay Tanner MP to the Sydney Institute Sydney, Thursday 26 February 2008, p 3.

If Treasury requires any further information concerning this submission, please contact John Kench or Anusha Kangatharan.

Yours faithfully

John Kench
Direct: + 61 2 8274 9537
E: john.kench@jws.com.au
Level 30
264 George Street
SYDNEY NSW 2000

Anusha Kangatharan
Direct: + 61 2 8274 9511
E: anusha.kangatharan@jws.com.au
Level 30
264 George Street
SYDNEY NSW 200